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GOLD, CREDIT AND EMPLOYMENT:
FOUR ESSAYS FOR LAYMEN

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GOLD, CREDIT & EMPLOYMENT

FOUR ESSAYS FOR LAYMEN

by

G. D. H. COLE

LONDON
GEORGE ALLEN & UNWIN LTD
MUSEUM STREET

HG 939 .C63

FIRST PUBLISHED IN 1930

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PRINTED IN GREAT BRITAIN BY
UNWIN BROTHERS LTD., WOKING

CONTENTS

		PAGE
	PREFACE	7
I.	GOLD, CREDIT AND EMPLOYMENT	11
II.	THE GOLD QUESTION	55
III.	THE GOVERNMENT AND THE UNEMPLOYED	99
IV.	CHEAPER MONEY, RATIONALISATION AND EMPLOYMENT	139

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PREFACE

The four essays which follow do not profess to be either academic or exhaustive. They are an attempt to outline, in the simplest possible terms and in a purely practical way, the elements of one of the most vital economic problems of our day—that of monetary policy in its relation to unemployment. The first essay has not been published before. The second and third appeared in *The New Leader*, and the fourth in *The New Statesman*. I have to thank the Editors of both these papers for their permission to reprint.

G. D. H. COLE

OXFORD,
April 1930

I

GOLD, CREDIT AND EMPLOYMENT

I

GOLD, CREDIT AND EMPLOYMENT

Gold is a commodity. It costs effort to produce, and has its cost of production in terms of labour and capital sunk in gold mining. It enters into exchange; for those who purchase it do so in order to sell it and get other goods in exchange, just like the producers of any other commodity, and there is a demand for it, both for use by goldsmiths and jewellers for plate, wedding-rings and other trinkets, and by dentists, and also for use as money or as a backing for money. Gold is produced, bought and sold, and consumed in much the same way as many other commodities, except that, as it takes a long time to wear out, its rate of consumption is very slow indeed.

Yet, though gold is a commodity, in many respects it does not behave like other commodities. To begin with, it is cheap when other commodities in the mass are dear, and dear when they are cheap. This is apt to confuse people's minds; but it is really quite simple. All buying and selling is really exchange of one thing for another. This is plain enough in a schoolboy "swop", or in any of those transactions, commoner among primitive people than among ourselves, that we call "barter". The exchange of so much ivory for so many Birmingham goods is clearly an exchange of commodities, though it may not be a fair exchange. Similarly, when I buy a packet of cigarettes for a shilling, I am really taking the cigarettes in exchange

for the quantity of gold that the shilling, as token money, represents.

Of course this is true only if the shilling, whatever it is made of, does represent a fixed quantity of gold, or in other words, if the country in which the transaction takes place is on a gold standard. That is what being on the gold standard means. It means that each unit of currency, of whatever it is made—silver or nickel or copper or paper—represents and is exchangeable for a fixed amount of gold.

If a country is not on a gold standard the situation is different. It may, like some countries in the Far East, be on a silver standard, in which case what I have said remains true, with the substitution of silver for gold. But it may, like most countries during and immediately after the war, not be on a metallic standard at all, but have simply a paper currency that is not exchangeable for gold or any other metal at any fixed rate. In such a situation the act of buying and selling is not an exchange of so much wheat or coal for so much gold or silver, but only for so much currency. This raises far harder problems than I want to discuss just yet: so let us be content for the moment with considering a country which is on a gold standard, as Great Britain is to-day. In such a country, I say, all buying or selling is an exchange of so much of some commodity or other for currency representing so much gold, and therefore, in substance, for so much gold.

We see now how gold, while it remains a commodity, differs in its use from other commodities.

Before the war, when we had actual golden sovereigns, we used to employ gold, side by side with bank-notes, silver and copper, as an actual medium of exchange. We used to buy things with it, or sell things for it, getting or giving actual gold coins. Nowadays we do that no longer in any of our ordinary internal transactions, though merchants and bankers may still use gold bullion in making certain payments abroad. The gold that used to pass from hand to hand in ordinary exchanges is now mostly stored up in the Central Banks of the various countries. In the hands of these banks it serves mainly as a backing for the paper currency issued in each country, and, in countries that are truly on a gold standard, the issue of currency is so regulated that each bank-note, or token coin, effectively represents so much gold and is of as much value to its possessor as so much gold. The bank will always buy gold offered to it with the fixed equivalent value in bank-notes and coins; and, broadly speaking, anyone who possesses bank-notes and coins can take them to the bank and get for them the fixed equivalent in gold.

We have thus, in most modern European countries, made of gold a *standard of value*, or universal equivalent. In theory, any other commodity might serve this purpose. We might measure all our transactions in terms of, say, horses, or corn, or iron, or anything else plentiful enough to serve as a standard. Indeed, in various ages and in various parts of the world, many different commodities have actually been used in this way, as we have seen that silver is still used in the

Far East. But in the developed industrial countries of the world, it seems to be a matter of common agreement that, *if we are to make use of any single commodity for this purpose*, gold is the best commodity to use. This is because, more than any other we have been able to find, it combines the following qualities: It is scarce, but not too scarce, durable, capable of almost absolute standardisation in quality, handy and easily transportable, not bulky, and an object of desire.

There would be a demand for gold, and it would accordingly command a price, even if it were not used at all as money or as backing for money. This is essential to its suitability as a backing for money, or at least was essential in order to enable it to achieve its status as money. It may be possible for us now to give up the gold standard and adopt a currency system that does not relate our money to any particular commodity as the measure of its value; but this would certainly not have been possible at the time when gold was achieving its position of pre-eminence as a standard of value. Gold was acceptable as money because people wanted it for its own sake, and not merely as money, and were therefore sure that it would retain its value, whereas the value of a paper currency depends entirely on the maintenance of its value by the authority which issues it, as the holders of war-time francs, marks and roubles have found to their cost.

Gold, then, is still used as a standard of value, though it no longer serves, in ordinary internal transactions, as a medium of exchange. The currency we

use no longer *is* gold; but it still represents gold. Accordingly, gold is still placed in sharp opposition to all other commodities, which are valued in terms of it. Whenever we say that a commodity is worth so many pounds, shillings and pence, we are equating it to so much gold; for the pounds, shillings and pence, whatever they may actually be made of, represent so much gold. It is easy, then, to see why other things are dear when gold is cheap, and *vice versa*; for when we call things cheap we mean that they are not valued at much in terms of gold, or in other words that it takes a lot of commodities to be equivalent to a little gold; and when we call things dear we mean that they are highly valued in terms of gold, or in other words that it takes a lot of gold to buy only a small quantity of goods. We are measuring goods in terms of gold and gold in terms of goods; and clearly both cannot be dear, or both cheap, at the same time and in terms of each other.

The prices of the things we buy and sell, except gold itself, are then at bottom gold prices; for, in a gold standard country, every price is only another name for an amount of gold. It is therefore very important to discover what fixes the value of gold in terms of other commodities, or in other words the price-level; for this is, for all of us, a vitally interesting matter. Some people have suggested that the value of gold must depend on the cost of producing it, in relation to the cost of producing other goods, in terms of the amounts of labour and capital needed for its production. But this idea is really not tenable. Each

gold-mine, and even each deposit within a mine, has a different level of cost, according to the ease or difficulty of getting the gold; and the companies which control the gold-mines produce more or less according to the price they expect to get for it. Just like the producers of other commodities, they reckon up their money costs of production and estimate the money prices at which they can sell their product, and determine how much to produce, and what mines are worth working, in accordance with the results of their calculation. The only difference between gold and other commodities in this respect is that the owners of gold-mines can always be sure of getting a certain minimum price for their gold by taking it to the banks and turning it into currency; for such banks as the Bank of England are always prepared to accept gold at a fixed price. The owners of gold-mines may get more than this money-price, for example, by selling their gold to the goldsmiths, if the demand is good. They cannot get less; for their gold *is* the equivalent of a fixed amount of money.

This, however, does not carry us far; for we are really concerned with the value of gold in terms not of money but of other commodities. This is a far more complicated matter; and the theory that is usually invoked in order to explain it is known as the *quantity theory of money*. Let us suppose for the moment that gold is exclusively used, not only as the standard of value but also as the medium of exchange. All things that are bought and sold have, then, to be bought and sold with actual gold. Clearly, unless other conditions

change, the price-level, or in other words the value of gold in terms of commodities and of commodities in terms of gold, will depend on the quantity of gold available and the quantity of transactions needing to be financed. The more gold there is to finance a given volume of transactions, the higher the price-level will bc. The more transactions a fixed quantity of gold has to finance, the lower the price-level will be. This is the essence of the famous quantity theory of money.

Even if gold is not used as money, but is used as a backing for money, in such a way that the quantity of money issued depends on the quantity of gold available, the situation is not radically altered. The theory then refers dircctly not to the gold, but to the money based upon it; but if this varies in accordance with the amount of gold, the price-level will still depend on thc quantity of gold available in relation to the quantity of transactions needing to be financed.

This is, of course, a very highly simplified account; and there are actually many complicating factors. But, in a broad sensc, it is true that the price-level depends at bottom, where countries are working under the gold standard, on the quantity of gold available for use as a backing for money on the one hand, and the quantity of transactions needing to be financed on the other.

Gold production tends to adapt itself to this situation, as far as the conditions of gold-mining and the capacity of the mines allow. If gold is scarce, and therefore commands a high value in relation to other commoditics, this encouragcs the owners of gold-mines

to produce more, and *vice versa*. This factor, however, is not of very great effect, for two reasons. First, because it is not very easy to adapt the output of the gold-mines at all rapidly to changing conditions; and secondly, because, gold being a very durable commodity, the annual production forms only a very small percentage addition to the existing stock. In practice, the quantity of transactions varies far more than the supply of gold, though there may be considerable variations in the gold supply of any one country, taken apart from the rest of the world.

Of course, the discovery of a great and productive new goldfield might upset this situation, by suddenly letting loose upon the world a big additional supply of gold. This has happened more than once—after the discovery of America, and in the nineteenth century with the successive opening up of the Australian, American and South African goldfields. It may happen again; but no one appears to consider this likely. The world has been well searched for gold without much success; and at present the mines of South Africa are responsible for by far the greater part of the new supply.

The gold standard is essentially an international standard, though not all countries work under it. During the war most of the leading countries, except the United States of America, were compelled to give it up. Since the war they have been gradually returning to it, under strong pressure from bankers and experts and from the League of Nations itself, acting under the influence of these same bankers and experts.

The importance of gold as an international standard

is that it brings the currencies of different countries into a definite normal relationship one to another. The pound sterling, the dollar, the *reichsmark* and the franc all represent fixed quantities of gold, and have therefore a normal rate of exchange one with another. This rate is not, indeed, absolutely fixed; but it can, under a full gold standard, vary only within narrow limits. These limits are, ordinarily, the costs of transporting actual gold from one place to another. Gold in New York is exchangeable for dollars at a fixed rate, and so is gold in London for pounds. But if my gold is in London, I can only get the fixed amount in dollars for it by moving it to New York. The rates of exchange between two countries may accordingly vary, even if they are both completely on the gold standard, up to the point at which it pays to move actual gold from the one to the other. This point, or rather the two points at which it pays to import or to export gold from this country to that are known as *Gold Points*. The amount of fluctuation within the gold points is fairly small; for, as we have seen, gold is cheap and easy to transport. Countries on the gold standard have therefore relatively stable exchange rates—or, in other words, there are only small variations in the rates at which their respective moneys can be exchanged one for another.

This relative stability possesses very great commercial advantages. It means that, if I agree to buy or sell anything in terms of francs, or marks, or dollars, I know within fairly narrow limits how much *in pounds* I shall have to pay or receive, whereas just after the

war, when the gold standard was in abeyance over most of the world, I could have no such knowledge; for the currencies of the various countries, not being measured in terms of any common standard, were liable to fluctuate in relative value to any extent, chiefly in accordance with the quantity of them in circulation in relation to the volume of transactions that they had to finance. This was highly inconvenient to traders, and came near to reducing all foreign trade to a gamble, at least at the height of the period of inflation in Europe. The desire to remove this uncertainty has been one of the main reasons for the desire of financiers to get back to the gold standard, by again relating each national currency to a definite amount of gold. This has now been done, in one way or another, by all the leading industrial countries. Great Britain, the United States, Germany, France, Italy, Holland and Belgium, as well as Canada, Australia and South Africa and many other countries, are now definitely on the gold standard.

Each country, however, has to pay a penalty, light or heavy according to circumstances, for the preservation of this standard. For it involves that each unit of each country's currency must be maintained at the value in gold that has been assigned to it. Anyone, as we have seen, where the gold standard is in full operation, can go to the Central Bank and get a fixed amount of actual gold in exchange for bank-notes or other currency. If, then, the gold which I can get in London in exchange for, say, a thousand pounds in bank-notes would be worth more in New York, I shall

evidently be tempted to demand the gold, and export it to New York in order to make a profit. But if a number of people do this, gold will leave England for New York; and, if the situation continues, in the long run England will be denuded of gold, and it will all be transferred to America.

Why would this matter? For two reasons, one artificial and one more fundamental. In the first place, under our present currency law the amount of bank-notes that may be issued depends on our stock of gold, so that if all our gold left the country the Bank of England would have to withdraw a large number of its notes from circulation. This, by reducing the quantity of money, would force down prices and cause trade depression, or alternatively would involve a great reduction in the volume of transactions that could be financed, and so cause depression in another way. Probably it would in fact react in both ways, and cause both some fall in prices and some reduction in the volume of transactions. It would be bound, in any case, to result in serious unemployment.

This result, however, is artificial. It arises from our currency law, and not from any natural cause beyond our control. We could amend our law, and go on issuing as much currency as before, despite our loss of gold. What would happen then? We should have reached the point at which, when anyone wanted to get gold in order to pay a debt abroad, the Bank would have none to give him. There would then be no sufficient reason why a pound should continue to be worth a fairly fixed amount in dollars, or francs, or

any foreign currency. We should have lost the *automatic* stability of the international value of our money in relation to the money of other countries. This is the more fundamental reason against action by any one country alone to give up the gold standard altogether.

It does not, however, follow that our currency would actually become worth less in terms of other currencies. Whether it did or not would depend on circumstances. Chiefly, it would depend on the amount of currency we put into circulation in relation to the volume of transactions needing to be financed. In other words, it would depend chiefly on our price-level in relation to the price-levels of other countries.

Now, the amount of currency that is needed in order to maintain a stable price-level varies, as we have seen, with the volume of transactions needing to be financed. This is not quite the same as saying that it varies with the quantity of commodities produced for sale; for other things besides the current products of industry are bought and sold, and enter into the volume of transactions. For example, there are all the transactions that take place upon the Stock Exchange in existing stocks and shares, sales of land and existing houses, and so on. These affect the amount of currency and credit needed to keep the price-level stable equally with transactions in the current product of industry. The fluctuations of Stock Exchange activity, in particular, have sometimes highly important effects on the demand for credit, and therefore on the level of prices, as happened in America during the recent boom.

While, however, we cannot identify the volume of

transactions needing to be financed with the volume of current industrial production, or maintain that a currency and credit policy which was governed entirely by the volume of production would suffice to keep prices stable, it is obvious that the volume of production is normally by far the most important factor influencing the demand for both currency and credit. We can say, roughly and in general terms, that if we produce more we shall need more money, unless prices are to fall, and that if we issue more money we shall need to produce more, unless prices are to rise.

Thus, in the case we set out to discuss, we could issue more money (currency and credit) without causing a rise in our internal price-level, if at the same time we produced enough additional goods and services to balance the additional issue of money. If we did this, there would be no reason why our currency should become worth less in terms of other currencies; for if our money continued to buy as many goods as before in this country, there would be no reason why foreigners should value it less highly. A pound to a foreigner, like a dollar or a mark to an Englishman, is worth just what it will buy; and the value of the pound in terms of the dollar would tend to fall only if the pound would buy less goods here or, of course, if owing to events in America the dollar would buy more goods in the United States. If we were speaking with strict accuracy, and taking full account of all the qualifications, this statement would need to be somewhat modified. But it is broadly true; and its truth is far more important than the reservations.

In plain terms, this means that the amount of currency and credit which we in this country, or the responsible authorities in any other country, can afford to issue, and need to issue in order to keep the internal price-level stable, depends primarily not on the amount of gold in the cellars of the Bank of England, but on the volume of current production. But if, under the gold standard, we do actually regulate our issue of currency and credit in accordance with our stock of gold, and not with the needs of our productive organisation, it is surely most unlikely that the amount arrived at in this way will coincide with our real needs.

In fact, it does not coincide; and this is at the root of many of our troubles. For, according to our present policy, if our stock of gold falls, that means we must manage with less currency and less credit, and accordingly we must either do less business, or our price-level must fall.

But, it may be urged, surely a fall in prices will cause people to buy more, and so stimulate employment. Surely the less people are asked to pay for a thing, the more of it they will be prepared to buy. Unfortunately, there are two flaws in this reasoning. It forgets the reaction of the lower prices on those who control production; and it forgets their reaction on the incomes of those who consume.

Suppose, first, that all incomes fall in correspondence with the fall in prices. Then clearly consumers can buy as much, but only as much, as before. Well and good, it may be said: we are no worse off, though we are no better. But, in fact, all incomes do not fall in this

way. Some fall more than others, and, in general, those incomes which, forming part of costs, are direct charges on the process of production are slowest in falling. The controllers of production therefore find that, at the new prices, it does not pay them to produce as much as before. They discharge workmen and curtail production, in order to keep up the price of what they still produce. Thus, the shortage of money comes to be met only in part by a fall in prices, and in part by a decrease in the volume of transactions. The workmen who are discharged have to live on "doles" supplied out of the remaining product of industry; and the whole community is worse off. Under-production sets in as the employers' instinctive defence against a fall in prices.

Nevertheless, prices do fall in some measure (usually to the greatest extent in the case of raw materials and semi-manufactured articles and capital goods, and less in the case of consumable goods, which determine the cost of living). This fall in prices discourages trade and production in another way. Until merchants and manufacturers think that prices have touched bottom, they buy as little as they can, because they know the things they buy are likely to fall in value before they sell them again. Meanwhile the workers, the real value of whose wages depends on the retail cost of consumable goods and not on that of materials and capital goods, naturally resist wage-reductions which will decrease their purchasing power. But wage-rates, which represent for the workers incomes, or power to buy consumable goods, represent for the employer costs

of production. The employer therefore complains that wages are too high, and discharges men on the ground that he cannot afford to produce as much as before unless his costs fall. This is the vicious circle, due largely to the dual character of wages as costs and incomes, into which we fall in every trade depression.

A fall in prices due to a reduction in the supply of money is accordingly a thoroughly bad thing. Please note that I am not here discussing reductions in the prices of particular commodities, or in the general price-level, due to non-monetary causes. If the efficiency of a particular industry, or of industry in general, increases so that more goods are made with less expenditure of effort, the prices of the particular goods affected will tend to fall, even if monetary conditions remain unchanged. This fall in prices, though it proceeds from a highly desirable cause, may set up undesirable reactions in certain cases; and we shall need to discuss this point later. But it is quite a different point from that with which we are now concerned. We are dealing solely with a fall in prices that is due to a restriction in the supply of money; and it is this that is thoroughly bad in every way.

Why, then, do we allow our monetary policy to be dictated by the fluctuations in our supply of gold, instead of keeping our price-level stable by regulating our issue of credit and currency in accordance with the internal needs of our productive system? Why not simply abolish the gold standard, and adopt the method of managing our currency and credit policy without

any relation to the supply of gold? What is gold, that it should play the tyrant over us so to our undoing?

Put that question to an articulate upholder of financial orthodoxy, if you can find one. He will answer that the ebb and flow of our gold supply are signs of something else, and must guide us in our monetary policy because of that which they express, and not for their own sake. He does not, he will say, worship gold, or regard gold as important in itself; but he does think that the movement of gold to or from a country shows how its monetary policy ought to be managed.

Gold, he will tell you, tends to move to those places in which it is worth most, or, in other words, where it will buy the largest quantity of goods. If, then, gold is tending to flow out of Great Britain, this is a sign that gold will buy less in Great Britain than it will buy somewhere else. More simply, it is a sign that the British price-level is too high in relation to the level of prices in the country or countries to which the gold is tending to flow. Accordingly, says the orthodox financier, the British price-level must be brought down; and, in order to achieve this, the amount of currency and credit in circulation in Great Britain must be reduced. The price-level must be, he urges, in approximate equilibrium all over the world, or at any rate in all the leading industrial countries; and a loss of gold by Great Britain is important less in itself than as a sign that British prices are out of adjustment with world prices.

This argument undoubtedly contains a measure of

truth. But it rests on an unstated hypothesis, and, if it is used as an argument for the gold standard, it is in effect an argument in a circle. For it is only the gold standard that allows our prices to be out of adjustment with those of other countries. If each unit of our currency were not exchangeable for a definite amount of gold, our price-level could not get out of step; for foreigners would simply value our currency in terms of their own in accordance with their relative purchasing powers. A change in the rates of exchange between our currency and those of other countries would keep our money regularly in adjustment with others, and exchange rates would fluctuate as often as might be necessary to preserve the right relationship. This, of course, is precisely what happened after the war before we returned to the gold standard; and it is what happens now in the case of countries not on a gold standard.

Clearly, then, this argument cannot be used as an argument in favour of the gold standard, since, if there were no such standard in operation, it would not apply at all. What those who use it really mean is that stability of exchange rates between our money and the money of other countries is so important that it must be preserved, and that gold is the only *automatic* method of preserving it. We might, indeed, preserve stable exchange rates without actually being on a gold standard. But we could not do this *automatically* without the gold standard: we should have to do it by "managing" our currency and credit issues in such a way as to keep their volume at the right level for

seeuring the correspondenee of our internal priee-level with the level of priees in the world as a whole.

But this, the orthodox financiers go on to say, would mean that, even if we were not on the gold standard, we should still have to behave exaetly as if we were. We should have to issue just as mueh curreney and eredit as we issue now—neither more nor less—because that is the right amount to keep our priees and world priees in the proper equilibrium. In other words, we should gain nothing by giving up the gold standard, while we should lose the automatic stability of our exchange rates whieh our adherenee to it guarantees.

The effeet of the last few paragraphs has been to transfer the argument to a different plane. It is fundamentally not about gold that we must argue, but about rates of exchange. Is this stability of exchange rates, whieh turns out to be the real basis of our finaneiers' devotion to the gold standard, really as overwhelmingly important as they seem to believe?

Before we attempt to settle this diffieult question, it is neeessary to make one thing clear beyond dispute. Whatever may be the position at some distant future time, it is for the present quite impossible to stabilise both exehange rates and internal priees. We eannot fix both the internal and the external value of our money. If we set out to stabilise exehange rates, or in other words the purehasing power of our money in terms of foreign curreneies, we eannot possibly at the same time stabilise its power to buy goods at home. Equally, if we set out to stabilise our own internal

price-level, we cannot possibly at the same time stabilise the value of our currency in terms of foreign currencies. A very little consideration should suffice to make this plain to everyone, though a good many people do not appear to have grasped it yet.

If world prices were stable, then of course the thing might be done; for in stabilising exchange rates we should be relating our own price-level to a fixed price-level outside. But world prices are not stable and accordingly anything that serves to fix the value of our money in relation to them involves instability in our own level of prices, which must, under such a system, respond to changes in the level of prices in the world as a whole. Some day, perhaps, the world will be enough of an economic unit to possess a common currency and a single international credit policy; but that day is certainly not yet. For the present, world prices remain unstable; and the gold standard, by fixing the relation of our currency to those of other countries, decrees that our internal price-level must fluctuate in accordance with world conditions. If it did not, gold would be drained away from Great Britain to countries in which it would buy more than here.

Again at this point, I am consciously simplifying the real facts, in order to bring out their essential significance. And, lest I be misunderstood, the general nature of this simplification must be briefly explained. When I say that, under the gold standard, our internal prices must be kept in equilibrium with those of other countries, I do not mean that everything costs, or

even tends to cost, the same amount of gold money all over the world. The actual price-level in each country is affected by many causes. Tariffs, for example, usually raise prices; and so do some forms of taxation. Costs of transportation also enter into the prices which particular things fetch in particular places, and so react upon the general price-level. Moreover, the tendency towards international equalisation of prices acts with very different force on different goods and services. Such world-traded commodities as wheat, which is bought and sold all over the world and easily transported from one country to another, have a world price, whereas there is no such necessity in the case of, say, tram fares or doctors' fees, which have to be consumed on the spot. The chief cause that normally makes gold move from London to New York, or from New York to London, is the possibility of getting more for it in the one place than in the other. This may mean that it will buy more goods, of the sorts that pass current in world trade; or it may mean that it will earn more interest or profit in one place than in the other. There is therefore no complete equalisation of prices in different countries because of the gold standard, but only a strong tendency towards equalisation of the utility of money for purposes of trade or lending. Actually, the factor that most influences international gold movements under normal conditions is the movement of interest rates, as was seen when gold was flowing to America during the United States Stock Exchange boom.

This, however, while it is very important in itself,

need not concern us here. Our present point is, not that prices in all countries are equalised by the gold standard, but that they are kept in a sort of equilibrium by actual or threatened gold movements. If gold flows out of a country, or even if it threatens to flow out, because the price-level or interest rates in some other country offer more attractive prospects to financiers, the bankers take steps to correct this tendency by raising interest rates in the country which is losing gold. This both results in a restriction in the volume of credit, and tends to depress the price-level, while at the same time both the higher interest rates and the lower prices serve, if they go far enough, to attract the gold back in order to take advantage of them.

Changeable internal prices and interest rates are therefore necessary conditions of stability of foreign exchange rates—of that stability within narrow limits which, as we have seen, the gold standard guarantees. We cannot stabilise both exchange rates and internal prices—both the external and the internal value of our money. We can do either, perhaps, but not both.

Suppose, for a moment, that instead of fixing our exchange rates by means of the gold standard, we set out to stabilise internal prices, while leaving exchange rates free to fluctuate. We should then, as Professor Irving Fisher has suggested for the United States, regulate our internal issue of currency and credit in accordance not with our stock of gold, but with the needs of industry for money at the prevailing level of prices. The relation between our currency and those of other countries would thus fluctuate chiefly in

accordance with changes in *their* price-levels, or with the level of world prices as a whole. The pound would be worth more or less dollars, or marks, or francs in accordance with price changes abroad; and it would also be worth more or less gold in accordance with these changes. Professor Fisher proposes that, in order to keep prices stable in the United States, the American Government should alter the amount of gold for which a dollar would exchange in accordance with changes in the economic situation. The dollar, under his scheme, would have always the same power to buy goods in the United States; but its power to buy goods anywhere else, or to exchange into foreign currencies, would be constantly varying. If we set out to stabilise our internal price-level, we should have to treat the pound in exactly the same way. A pound would be equivalent no longer to a fixed, but to a variable, amount of gold.

What is the objection to our doing this? Almost everyone agrees that it would be a good thing if our internal prices were stable; and it appears to be well within our power to make them so, if we agree to allow exchange rates to fluctuate. The trouble is that, as we have seen, the financial world sets great store by stable exchange rates—more than it sets by stable internal prices—and that it is impossible for us, under present conditions, to have both. We have to choose which we prefer.

In our return to the gold standard, we chose stable exchange rates. Why? There were several reasons, the force of which cannot be ignored. In the first place,

Great Britain is more dependent on international trade than any other country in the world. Now, it is of great importance to the importer, say, of wheat to know how much of English money he will have to pay in order to make a payment of so many dollars in a week's, or a month's, or a year's time. Similarly, it is of great importance to the exporter of, say, coal, or machinery, or cotton goods, to know how many English pounds he will get for so many dollars, or francs, or marks, or pesetas, or what not. Within fairly narrow limits, marked by the gold points, the gold standard accomplishes this between all gold standard countries. It has therefore considerable advantages, from the standpoint of those engaged in external trade. In the period of unstable exchanges after the war, traders had ample reason to realise the disadvantages of exchange fluctuations. They might gain or lose by particular fluctuations; but the fact of fluctuation introduced an element of gambling into all overseas commercial transactions.

Similar considerations apply to all other payments which British people, or the British State, may have to make or receive in foreign currencies—to our debt to America, which we have to pay in dollars, or to the large dividends on overseas investments which are payable in foreign currencies to British investors. Stable exchange rates practically fix these and similar payments in terms of British money; and that is an advantage not to be decried.

The case for the gold standard rests, indeed, mainly on this point, with the addition that the status of

London as a world financial centre depends on the preservation of this fixed relation between our currency and those of other countries. The City performs many and varied financial services, of which the issue of bills of exchange may serve as an example, for foreign as well as British traders and financiers. It levies a handsome profit on these transactions; and the Treasury, as well as the City, is interested in the maintenance of this profit. In addition, there is often lying in London, and available temporarily for use in this country, a large amount of money belonging to foreign owners who know, because of the gold standard, that they can always change it back into a practically fixed amount of their own currencies when they want it. Without this certainty, London could certainly not remain the banker of Europe to anything like the extent to which we have grown used; and the loss of the position would both involve the disappearance of a handsome profit which is now realised by the City, and perhaps prejudice our international trade into the bargain.

It is, for these reasons, impracticable to suggest that we should give up the gold standard, as far as it is essential to the maintenance of stable rates of exchange. Those who urge that we should do this have not sufficiently counted the cost. But does it follow from this that we can do nothing, and that our present banking policy is right? Can we not maintain stable exchange rates, and at the same time emancipate ourselves in some degree from the control which the fluctuating supply of gold is at present allowed

to exercise over our policy in issuing currency and credit?

The purpose of this little book is to suggest that we can, and that both the whole-hogging defenders of the gold standard and those who subject it to unjustified condemnation are in the wrong. In the interests of clear thinking, it is vitally necessary to keep distinct two separate, albeit connected, uses which we at present make of gold. We use it to make and receive certain international payments; and we use it as a basis for our issue of currency and, indirectly, of credit as well.

If the argument contained in the foregoing paragraphs is correct, there are strong reasons why we should continue to employ gold for the former purpose, and to allow anyone who so desires to obtain, for the purpose of making an international payment, a fixed amount of gold in exchange for each unit of our national currency. We may, if we will, impose restrictions on the manner in which such payments are to be made; but in the last resort it must be open to anyone who has so many pounds of English currency to get for them either a practically fixed amount of any foreign currency of a gold standard country, or the actual gold which he can change into such a fixed amount by transporting it to the country in question. But is it either necessary or desirable, in order to safeguard this right or for any other reason, that we should cause, or allow, our internal issue of our own currency to fluctuate in accordance with the variations in the stock of gold in the possession of the Bank of England?

I suggest that it is not, and that the exchangeability of our currency for the currencies of other gold standard countries at a practically fixed rate can be assured without paying this price, and so depriving our issue of currency and credit of almost all adaptability to our own internal needs. I suggest that, without getting more gold, or even if the Bank of England had far less gold than it has to-day, we could increase our issue of currency and credit, without causing our prices to rise or our exchange rates to fall, if the additional issues of currency and credit resulted in a proportionate increase in the volume of domestic transactions needing to be financed, or, in other words, broadly speaking, in a proportionate increase in the volume of domestic production and consumption. This is the point which I have sought chiefly to develop and elucidate in the following pages; for I believe that, in most people's minds, the two points which I am trying to distinguish are still not kept distinct. It is not sufficiently realised that the equivalence of each unit of our currency to a fixed amount of gold and the backing of all currency above a fixed fiduciary limit by a hundred per cent. of gold are not two inseparable features of one policy, but two distinct and separable policies. There may be good reason for the one, and quite inadequate reason for the other.

There is in the world at present a definite shortage of gold, in relation to the world's estimate of its needs of that remarkable commodity. There is likely, unless current estimates of the future volume of gold production are wildly wrong, to be a still more acute

shortage before many years have passed; for the output of the South African mines, which provide the bulk of the world's new supply, is likely before long to reach its peak, and then rapidly to decline. Of late years, more and more countries have been adopting, or returning to, the gold standard, and have been seeking to build up gold reserves of their own in their Central Banks. Most of these countries use gold not only as a means of settling certain international debts, but, far more, as a basis for their internal issues of currency. Consequently, most of the world's stock of gold is, to all appearance permanently, immured in the vaults of the various Central Banks. It is not used to make payments: it just stays there as a backing for the bank-notes which are actually employed in internal transactions. Under normal conditions, world productive power, and with it actual world production, should steadily and rapidly increase from year to year. If, however, the supply of gold increases but slowly, and is likely to grow at a decreasing rate, and if further the issue of currency and credit is in most countries restricted in accordance with the amount of gold backing that is available, it follows that an increased volume of transactions can be financed only at a decreasing price. The price-level must fall. Moreover, as we have seen, this falling price-level discourages increased production, while any successful attempt by producers to maintain prices only results, in the existing monetary situation, in decreased production and consequent unemployment.

Unless large economies are somehow made in the

use of gold, this situation is likely to continue, and to become accentuated within the next dozen years. One possible way of economising in the use of gold is to decrease the proportionate gold backing required for issues of paper money where, as in most countries, the existing requirement is a proportion of the value of the notes issued, or to increase the fiduciary issue where, as in this country, the present basis is a fixed fiduciary limit. This would, no doubt, serve to ease the situation; and there is no reason at all why it should not be done. The gold which is held purely as a backing for notes, and is over and above any amount likely to be needed for the making of actual international payments, is in reality absolutely useless and without function. It exists, in each country, solely as a precaution against such an over-issue of notes as would cause a rise in prices, or prevent a fall in prices, called for by world conditions. There would be no sense in it at all, if without it those who control the issue of currency in any particular country could be relied on to behave with reasonable common sense.

Probably, when the evil consequences of a falling level of world prices have been more fully realised, the world in general will decide to economise in this way in the use of gold, and to issue currency with a smaller proportionate backing of actual gold. But a mere increase in the fiduciary limit, or a decrease in the proportionate reserve required, would be in danger of leaving the volume of currency as inelastic and unresponsive to internal needs as it is now, when once the readjustment had been made and its effects absorbed into the

financial system. International agreement to reduce reserve requirements, or even separate national action to this end, would be better than nothing, and would temporarily relieve the situation, and both check the fall in prices and permit of expanded credit and production. But it would not provide a lasting cure, or create a currency system adaptable to changing needs.

The truth is that there is no need for any gold backing at all for any internal note issue. All that is needed is that the Central Bank should keep by it enough gold to meet actual demands for gold to export. This it must do, in order to ensure stable exchange rates; but not one ounce of gold beyond what is needed for this purpose is really wanted at all.

How far would it help us, if we acted on this principle, and treated our gold reserve simply as a supply available to meet possible demands for export, and not at all as a basis for our internal note issue? How far would such a policy enable us to expand our issue of currency and credit? Just so far as we could expand currency and credit without causing our price-level to rise in relation to the world price-level, and no further. For, if our price-level did rise materially in relation to the world price-level, there is no end to the gold we might need in order to meet actual export demands. No stock of gold, however large, could stand indefinitely the continued drain of such a demand. Our price-level, therefore would remain pegged to the movement of world prices, as long as we retained the convertibility of each unit of our currency into a fixed amount of gold. And this, we have seen, there

are strong reasons why we should continue to do. The benefit to us, therefore, of the suggested reform would depend on the extent to which it is really possible for us to expand currency and credit without raising our prices, or without allowing them to fall in correspondence with the actual fall of world prices.

This at once raises a most important issue. Prices, as we have seen, depend partly on monetary, and partly on non-monetary causes. So far, we have been studying the question purely in its monetary aspect; but at this point the other aspect has also to be considered. If the supply of money is increased, and the volume of transactions remains unchanged, prices rise; and in opposite circumstances prices fall. But equally if the supply of money remains unchanged, a change in the volume of transactions will react on the price-level. Thus, if goods are produced with less expenditure of capital and labour, and the volume of production consequently goes up, while the supply of money remains constant, the price-level is bound to fall. This is the non-monetary factor in the determination of the general price-level.

There can be no doubt that, in the world as a whole, the efficiency of production is tending to increase. The same expenditure of effort is tending to produce more goods; and this is happening faster than the supply of money is increasing. Or rather the combined effects of increased population and increased productive efficiency are outrunning the increase in the supply of money. Therefore, the world price-level is tending to fall.

But this increase in productive efficiency is proceeding at very different paces in different parts of the world. This fact considerably complicates the situation. For, as we saw, the price-level in any country is the result of both monetary and non-monetary causes. Where efficiency is improving, prices will tend to fall if monetary conditions remain unchanged; and prices will tend to fall most rapidly where there is the greatest improvement in the efficiency of production. Any country in which productive efficiency lags behind the general rate of advance will therefore tend to find its price-level out of adjustment with the world-level. The rates of exchange will therefore tend to move against it, and gold to desert it for countries in which it can command a larger purchasing power. But, if this happens, the approved remedy, under gold standard conditions, is the raising of the Bank Rate and the restriction of credit. The result of these measures is that prices are lowered, not through improved industrial efficiency, but through trade depression and under-production and under-consumption.

This is probably one reason for the flow of gold in recent years to the American continent, where efficiency of production has probably been increasing a good deal faster than in the countries of Western Europe. It is not suggested that there are no other reasons for America's tendency to heap up gold; for clearly the fact that the United States is now the great creditor nation of the world counts as well. But against this has to be set the growing importance of the United States as an investor overseas—in Germany, for example,

as well as in South and Central America; and, in the actual movement of gold, it is probable that the relation between the American and the European price-levels has counted far more. Add to this the possibility of high interest rates and earnings on American investments; for these, apart from speculative exaggerations, are mainly results of the improving efficiency of American production.

Of course, the "efficiency" spoken of in the preceding paragraphs is measured purely in monetary terms. It is a matter of costs of production and their reaction on the prices charged for the things produced. That is why the statement that British prices are too high in relation to world prices is so often accompanied by the demand for a reduction in British wage-rates in order to bring down costs of production and so enable prices to be reduced. Such wage reductions, made with this object, may indeed be successful in restoring the equilibrium of prices for a time, if they are pushed far enough. But they are certain to be fiercely resisted by the workers, and likely to involve a real reduction in the standard of living of those who submit to them; for the cost of living is, in practice, most unlikely to fall in proportion to the fall in wage-rates, since the reductions in commodity prices are likely to be concentrated largely on goods produced for export and on capital goods.

Accordingly, a country in which real productive efficiency is advancing at less than the average rate could only keep its prices in adjustment with those of more progressive countries by repeated reductions in

the standard of living among its people; and, as long as the disparity in the rate of advance continued, there could be no end to this process of lowering social welfare, which would speedily react on wages in other trades besides those engaged in export. Moreover, the fall in the standard of life would necessarily react on demand, and cause depression and unemployment. Prices might be brought back into equilibrium, but only at the cost of chronic under-production and under-consumption. And these conditions would stand seriously in the way of improving, or even of maintaining, the efficiency of the productive system.

It follows that to embark on a career of wage-reductions is to begin the descent of a slippery slope into the abyss. The remedy for relative industrial inefficiency is not lower wages, but the promotion of greater efficiency. This is the fundamental case for the process now known as the "rationalisation" of industry. Unless we can produce as efficiently as our leading competitors, and improve our efficiency as fast as other countries, we shall remain at the mercy of monetary forces and unable to use our productive resources fully or to the best advantage.

This brings us back to the essential question that lies at the back of our entire argument. Can we issue more currency and credit for the purpose of financing increased production and better productive methods without causing our price-level to rise in relation to those of other countries, and gold to be drained away to such an extent as to threaten the effective convertibility of our paper-money for those who desire

actual gold for export? I believe that we can, if we set about the matter in the right way. But I admit that there are real and considerable difficulties.

It must be agreed, in the first place, that a more liberal issue of currency and credit by the Bank of England and the joint-stock banks would be likely, immediately and in the short run, to cause some rise in prices, or at least to check a fall in prices that would otherwise occur. This would be likely to happen, because the increased money would inevitably make its appearance in the market as purchasing power some time before the increased supply of goods that would be made with its help. There would be a "time-lag"; and, until the fresh goods appeared, money would be more plentiful than before in relation to goods. What would then happen? Under normal conditions, rates of exchange would tend to move against us, within the narrow limits allowed by the gold points, and we should tend to lose gold—a loss which might be accentuated by any development of political panic in the business world. But, if the new goods, when they came, were enough to balance the extra money, this adverse movement would be purely temporary.

I hold that we ought to face this situation and take the risks which it involves. First, assume that it does mean an actual and considerable loss of gold. This, I hold, would not matter, if the drain were only temporary, and we had enough gold left at the end of it to meet normal demands for export. It would not matter, even if we lost practically the whole of the

gold that is now held as a reserve against our internal note issue. This reserve, as I have tried to show, is utterly useless. We can well afford, if need be, to let it go, in order to make an end of our abnormal unemployment and trade depression.

But it by no means follows that we should need to do even this. Last year, while the American boom was in progress, we could have expanded our issue of credit only at this cost, because gold was, even without such expansion, tending to leave the country. But at present, thanks to abnormal depression in other countries, gold is no longer flowing from London; and a more liberal credit policy might merely check an inflow instead of causing an actual exodus of gold. At all events we could now afford to push our credit policy a long way further than a year ago with very much less likelihood than then of a heavy drain of gold away from Great Britain. The present time is quite exceptionally favourable for a movement of credit expansion designed to set industry on its feet. We can have no assurance that these favourable conditions will remain in being indefinitely, and it is therefore of vital importance that we should seize our opportunity while we may.

More credit, however, is not merely a matter of cheaper credit, within the limits of possible variations in Bank Rate and the satellite rates that surround it. It is easy for us just now to make money cheap precisely because the rest of the world, as well as Great Britain, is suffering from trade depression. This naturally makes manufacturers and traders reluctant to borrow more,

because their markets, especially abroad, are contracted owing to the world-wide slump. Accordingly, the present low Bank Rate is having no great effect as yet in stimulating industrial borrowing; and those who have resources to lend are hard put to it to find borrowers even at the low rates now prevailing. That is why the Chancellor of the Exchequer has been able for the moment to borrow money for a short time on Treasury Bills at an abnormally low rate of interest.

The mere offer of cheap credit for short-period loans will, under present circumstances, be of little avail, both because manufacturers and traders have no confidence in their ability to sell more goods, and because for many purposes short loans are of no use and money is wanted for an extended period, or even permanently. Take the latter point first. If a manufacturer is considering whether it is worth his while to re-equip his factory with up-to-date plant, or to build a new factory on more modern lines, the fact that he can get cheap money for a few weeks or a few months is of little importance to him, if in a few weeks' or months' time he may have to pay interest at a much higher rate. He wants money, not to use for a few weeks or months, but to lock up in an undertaking whose returns will be spread over a period of years.

The same considerations affect those who have money to lend. Unless they feel assured that the low interest rates that prevail for short-time borrowings are likely to continue in force for a considerable period, they are not willing to lock up their money for a long period at a low rate of interest. Bank advances made

for short periods cannot ordinarily be used for the financing of long-term capital developments; and there is no necessary correspondence between variations in short-term rates of interest and the rates charged for long-term loans. The joint-stock banks for the most part, in their desire to keep their assets in a liquid form, confine their activities to short-term lending, though they may be, as we shall see in a later essay in this volume, on the threshold of some change of policy in this respect. But in any case, interest rates for short and long loans depend on widely different considerations, and need not by any means vary together or by corresponding amounts. The recent heavy fall in short-term rates has been accompanied by only a slight fall so far in the rates for long-term borrowers.

The low Bank Rate will not by itself bring about a revival of long-term investment because it gives the borrower no assurance for the future. The Bank has lowered its rate in view of the world depression; but only a few months ago it was fixing its rate high because of the American boom and the drain of gold to France. What it has done before it may do again; and therefore the present cheap money fails to exert a corresponding influence on lenders to make long-term loans at very cheap rates or on industrialists to borrow heavily in order to carry out capital improvements.

If, however, we were right in what we said a page or two back, this sort of expenditure is just what is needed. Our industrial efficiency has been, in many industries, lagging behind the general pace of world

improvement; and this fact is largely the cause of the difficult monetary conditions we have had to face. The remedy lies in improved efficiency; and this can be got only by spending money in such a way as to lock it up over a long period. This, however, will not be done on a sufficient scale, unless the State either undertakes the improvements and takes the risk itself, or some guarantee is given to borrowers of the continuance of cheap money for their enterprises over a period of years.

Let us now return to our other point. The present low money rates are not even effective in inducing manufacturers to produce, and traders to buy, on a larger scale, because in the present depressed condition of world markets they see no prospect of a remunerative sale for an increased quantity of goods. The purchasing power of our overseas customers is depressed —by the fall in the prices of raw commodities, by the fall in the price of silver, by the reaction which has followed on the heels of the American speculative boom. There is little demand, therefore, even for expanded short-term credits, despite the fall in the interest rate.

The remedy for this situation can evidently be sought only in the home market. Here lies the case for an extensive State scheme of public works for the provision of employment. The State can now borrow money for the purposes of such a scheme at exceptionally favourable rates; and it is well worth the State's while, though it may not be worth the while of the private employer, to take the risk that rates may rise later,

before there has been time to pay off the loans. For the State, and not the private employer, has to bear the burden of maintaining the unemployed. The provision of employment in this way would directly stimulate home demand, both by the payment of wages to the persons engaged and by the stimulus which the scheme would give to the constructional trades—now abnormally depressed—in the demand for materials. This is by no means the whole case for employing the unemployed, instead of paying them the dole; and a later essay in this volume develops more fully certain other aspects that are no less important. But the financial aspects of the question are important, and furnish excellent reasons for taking action now, when all the monetary conditions happen to be quite exceptionally favourable.

Action by the State to provide employment has, then, two distinct aspects. There is need, on the one hand, for long-term capital and credit for the reorganisation of industries on more efficient lines and, on the other, for a big emergency scheme of public works designed both to use the services of the unemployed and to promote the revival of home demand. The orthodox upholders of the gold standard and of our traditional banking policy have hitherto set their faces firmly against the latter of these methods, and have done little to encourage the practice even of the former, though they have sometimes paid lip-service to it. They have held firmly to the belief—erroneous, as I have tried to show—that the effective maintenance of gold as the measure of the value of

our currency involves a complete subordination of our financial policy to world forces, and a direct dependence of our issues of currency and credit on the ebb and flow of gold. Until these superstitions are broken down, I for one can see no hope of a successful handling of our unemployment problem, or even of the successful "rationalisation" of our industries. For "rationalisation", unless it is accompanied by a change in financial policy, will in all likelihood only accentuate the existing and fundamentally absurd disparity between our power to produce goods and our power to get them distributed. This little book deals only with certain special aspects of this key problem of modern economics; but I venture to think that these special aspects—the financial—are responsible for most of the taboos which at present forbid men to think straight or act sensibly about such matters as trade depression and unemployment.

II

THE GOLD QUESTION

Reprinted from *The New Leader*
of October and November 1929

II

THE GOLD QUESTION

After what Philip Snowden said at Brighton, those of us who are out for financial reform have to mind our P's and Q's. We must not be the fools who leap in where even a Socialist Chancellor of the Exchequer has evidently to tread with care. We must not put ourselves in a position in which we can be described as "currency cranks", or "inflationists", or merely "ignorant" critics of the Bank of England and its policy. Philip Snowden deals harshly with such people; and many of them deserve it. But, if we must take special care not to talk nonsense, we must take still more not to be driven from our point of view. Those of us who want to see drastic financial changes are on our mettle. It is incumbent upon us to make our position perfectly clear, and to back up our conclusions with arguments that will stand even Snowden's scrutiny.

It is of no use for us merely to rail against the Bank of England for raising its rate; for, according to all commonly accepted standards of financial policy, the Bank's action was perfectly correct. A higher rate of interest on borrowed money may be, from the standpoint of industry, a dire calamity: it may do far more to cause unemployment than Mr. Thomas and all his colleagues can do to prevent it: it may even be ineffective for the purpose which it was designed to serve. Nevertheless, the Bank acted, from the orthodox standpoint, in the only way that was open to it. For the

price and the supply of credit in this country must depend, according to the tenets of the financially orthodox, not on the needs of British industry and trade, but on a world situation over which the country has only a very partial and indirect control. On this view, the volume of credit we can afford to create depends on the amount of gold that is lying in the coffers of the Bank. The quantity of gold depends on the price we are prepared to pay for it in comparison with other people who want it.

This price is the rate of interest; and if we offer a high rate, more gold will come our way. The efflux of gold was a proof that we were not offering enough; and accordingly the Bank Rate had to rise, and with it the charge for temporary monetary accommodation of every sort. If the Bank Rate as it now stands is not effective in bringing gold back, then, still according to the orthodox argument, the rate will have to be raised again, and, if need be, yet again, until it achieves its object. Meanwhile, credit will be dearer and less abundant; but industry will have to put up with that as best it can. We must have the gold; and there is no way of getting it except the offer of more goods—that is, of a higher rate of interest—for its use.

This is, of course, a highly simplified version of the orthodox argument. I am trying to reduce the matter to its bare essentials, in order both to make it easier to understand and to make the really vital points stand out apart from the mass of detail with which they are involved. The gist of the matter, as seen by the orthodox, does lie in the price of money, as affected by the supply

of it and the demand for it in the different countries of the world. Money, it is said, is fetching a better price elsewhere—in Germany and America, for example—than it is here. Therefore money is leaving the country and a part of the loss of monetary resources is taking the especially serious form of a loss of gold.

Taken as a whole, this is a correct enough statement of the facts, or at any rate of some of the facts. But why do we get so excited about the export of this particular commodity? Generally, we regard it as a cause of rejoicing when the volume of any of our exports (or re-exports) goes up. Gold is a re-export. We import it, mainly from South Africa; and then we re-export it elsewhere. Why should we be pleased when our re-export of, say, rubber goes up, but be filled with gloom when the same thing happens in the case of gold? It seems, on the face of the matter, a very odd contrast; and it seems all the odder that the professional economists should share in the general gloom. For almost the first lesson one learns in economics is that gold is a commodity like anything else, and that the people who used to suggest that gold was wealth, and stood in sharp contrast to other commodities, were the biggest fools on earth. If that is true, why worry about the loss of it? Why not say that our exports have increased, and take the loss of gold as a sign of expanding trade?

The reason, of course, is in the main that we, in common with other gold standard countries, have chosen to base our currency on gold, with the result that a loss of gold will mean a lessened supply of the "means of payment". Why do we do this? The supply of gold,

which depends on the varying conditions of gold production and on the demand for gold in the world as a whole, can have no possible relation to our own internal need for currency. Yet we are not alone in following this seemingly inexplicable policy. Since the war, one country after another has been making the most determined effort to get back to a gold standard, often consciously causing a great deal of unemployment and distress for the sake of attaining to it. The League of Nations has been actively urging all countries to do this; and most of the leading economists appear to regard it as obviously the right policy. Why? It seems, on the face of the matter, merely silly. But obviously it cannot be merely silly.

The only plausible case for the gold standard is that it is a common international standard. If the currencies of all countries are measured in gold, they are all measured in terms of the same thing, and therefore must bear, subject to minor deviations, a fixed relationship one to another. This does not apply to paper currencies that are not related to a fixed metallic standard. A paper franc, or mark, or rouble, as such, may be worth any number of pounds, or any fraction of a pound. There is nothing to fix the relative values save the quantity of goods for which each will exchange; and this may vary from day to day according not only to the quantity of paper that is put into circulation, but also to a thousand other changing conditions. But if a pound, or a franc, or a mark is, or can be, freely exchanged for a fixed and unchanging quantity of gold (and that is precisely what the gold standard involves),

then, in terms of gold, each national currency stands in a quite definite relation to each and every other.

This is obviously most convenient for those who have to make or receive payments, and especially future payments, across national frontiers. During the German inflation, a man who had to pay or receive so many marks, say, a month hence could form no accurate idea of how many pounds sterling he was to get or give. This made international transactions very risky and difficult; and the world was strongly urged to come back to gold as the one readily available common standard for the currencies of all trading nations.

Evidently this argument has very great force. A common standard for international payments is highly desirable, and for this purpose there is no ready substitute for gold to hand. But does it follow, because a country can best calculate its external payment in terms of gold, that it must also use gold as the basis of its purely internal transactions? If there were no special difficulty in buying as much gold as we want (as there is none in buying as much wheat, or coal, or rubber), or if the available gold were somehow shared out among the nations of the world on a basis of need, there would seem to be a strong case for using gold in this way. But, in fact, the shortage of gold has already led us, and other countries too, to give up using it as a material for the actual currency which we handle. We no longer carry golden sovereigns about with us: we use bits of paper instead. Here is strong evidence of a real shortage, and everyone, I believe, now admits that we are most unlikely ever to return to an actual

currency of pounds sterling. The gold which is the basis of our bank-notes lies idle in the Bank. It does nothing at all: no one except the Bank officials ever sees it. If it were not there at all, but everyone believed it to be there, the belief would evidently be just as good as the reality. And actually the Bank has not even got nearly all the gold which its bank-notes are a nominal promise to pay. There is nowadays a huge "fiduciary issue", backed by no gold at all, and fixed, by a recent Act of Parliament, at a purely arbitrary amount of £260,000,000. If the "fiduciary issue" does no harm, why do we need any gold to cover the remainder of our notes? We do need enough to meet possible demands for actual gold for export; for our paper-money has no value outside this country. But we have far more than enough gold for this purpose; and yet we are terribly upset because we have lost a few millions. Why should the loss matter? We have, it is admitted, far more left than we are ever likely to use.

This locking-up of masses of gold in the vaults of the Bank is sheer waste. Observe, please, that we are not the only people who are doing it. America has far more gold than we have, or than she needs even as a basis for her currency according to orthodox ideas; France, too, has far more than we have; and other countries, which have less, are making frantic efforts to get more. That, indeed, is a large part of the trouble. The commercial nations of the world are scrambling to increase their stocks of this peculiar commodity, which they feel they must have, not because they want to use it, but in order to lock it up out of sight. The more

countries go back to the gold standard, the more furious the scramble grows. And it is largely to Great Britain that these countries come for gold, because we get directly most of the South African supply, and because we put, nationally, no restrictions in the way of export.

I want this whole question of the keeping of a huge idle gold reserve as the nominal basis of our national paper currency to be most carefully examined by people with minds open enough to consider the matter on its real merits. I think we should do better with a managed currency that would set free all this gold, and let other countries take it if they want it in order to keep up the old fetichism. But it is important to keep this question distinct in our minds from the question of continuing to use gold as a basis for international payments. If we are to go on doing that, we shall still need some gold, though not nearly as much as we think we need at present. Accordingly, we shall have still to keep our eye on gold movements, and to some extent to adjust our policy to them. In other words, we shall certainly not be in a position to print as much paper-money as we like, and damn the consequences. To attack the present working of the gold standard is not to advocate inflation, as I hope I shall be able to make clear.

II

On the desk in front of me, as I sit writing these words, is a golden half-sovereign. Someone—a friend—gave it me as part of the change for a pound note the other

day. The occasion was unusual enough to call for comment. It was years since I had seen a gold coin until this one came my way. Yet before the war I had often a sovereign or two in my purse; and gold coins passed freely from hand to hand in ordinary everyday transactions. Now, instead of gold, we use paper. Bank-notes are, indeed, promises to pay so much gold; but I never think of taking them to the Bank and demanding gold for them. Paper does well enough, as long as other people regard it as being worth the value printed on it.

True, some people say they would sooner have the old coins back, and sigh for the dear dead days beyond recall. But nearly everyone agrees that they are beyond recall, and that we shall never take to using gold again for our ordinary internal payments. Gold is too expensive, or too scarce, they tell us, for enough to be available for use in that way. If we were to cut out pound and ten-shilling notes and use gold coins instead, we should need far more gold than we have now; for the larger part of our note-issue is not backed by gold lying in the vaults of the Bank of England. And if every other country that is on a gold standard took to using only gold coins instead of notes, the world's gold supply would be gone in a twinkling, and all the nations would still be clamouring for more.

This does not mean that the thing would be utterly impossible to do. Let us see what would happen if it were done. Each country would refuse to issue any supply of currency in excess of the available supply of the precious metals (apart, of course, from small

change made of the base metals). This would mean that there would be far less currency in the world than there is now.

What would happen? One or all of three things. Each unit of currency would be able to buy far more goods—or, in other words, the price-level would fall with a resounding bump. Or, again, the supply of goods would be reduced as well as the supply of money, because of the "tightness" of the available currency and credit reacting on people's ability to produce. Or thirdly, the world would find means of making each unit of currency do more work, either by turning it over faster (increasing its *velocity of circulation*, as the economists say), or by dispensing with the use of currency at all in some kinds of transactions in which it is now commonly used (e.g. by making more payments by cheques or trade bills and less in cash).

In all probability each of these things would happen in some degree. If we were put to it we could dispense with quite a lot of cash payments. Wages, for example, might be paid by employers by cheque or even directly into a bank, and wage-earners might pay their accounts by cheque instead of using cash. Further, a diminished supply of money (in its metal form) would almost certainly mean a diminution of bank and similar credits, and this would almost certainly cause less goods to be produced.

But, though both these factors would serve to some extent to keep up prices, it is also practically beyond question that there would be a heavy fall in the price-level. For the diminution in the supply of money would

act at once, whereas both the counteracting factors would take time to get into play and to produce their effects.

Of course, such a situation as I have imagined is politically, though not physically, impossible. No one proposes to bring it about. But, in a less degree the progressive return of the world to the gold standard has been producing just these results. It has been causing prices to fall; it has been checking the supply of goods as well as of money; and it has been causing the world to try to be more sparing in the use of cash and to substitute other methods of payment for cash-payments.

Now, at least one of these results is admitted to be thoroughly bad. The world needs not less goods but more, and anything that checks production is, so far, clearly evil. The other two are in themselves neither good nor bad. Low prices are not intrinsically better than high prices; what matters is not the level of prices but the relation it bears to people's incomes.

Falling prices, however, have very serious disadvantages, because they check production. It takes some time to produce goods; and when prices are falling, both the materials used up in the productive process and the work done are losing their value while the process is going on. If I have £100 and leave it in the Bank while the price-level is falling, I have still £100 in the end, *and can buy more goods with it.* If I spend my £100 on buying, say, cotton yarn to weave into cloth, the value of my yarn is likely to fall with the fall in general prices, leaving me not with £100 worth

of purchasing power but with something less. Falling prices discourage producton in this way.

For some years past the world's price-level has been falling, and the return to the gold standard has been largely responsible for the fall, because it has carried with it either a positive decrease in the supply of money or at least a refusal to allow the supply to expand in proportion to the increase in the world's ability to produce. This falling price-level has had, I know, its compensations. It has increased the purchasing power of wages where their money amount has remained without change, or has fallen by less than the reduction in the cost of living.

The Conservative Government used to take great credit to itself for thus increasing the real value of wages by forcing down the price-level, or rather allowing it to be forced down by the world's return to gold. But, in my view at least, the working class lost more than it gained. Each pound of wages buys more; but there is more unemployment, and the widespread depression of trade reacts on the bargaining power of those who are employed. Consequently, less is paid in wages, both because the unemployed get none and because the Trade Unions cannot, under these conditions, bring effective pressure to bear for advances.

We have, however, it is urged, no alternative. The fall in prices is a world fall, not confined to this country. That is true, for it is bound up with the gold standard and with the world's way of returning to it, under the explicit directions of the League of Nations and the various international financial conferences which have

been held since the war. What, it is asked, can we do, except yield to forces which are beyond our control? Moreover, it is added, the return to gold has achieved at least one highly desirable thing. It has, as I said at an earlier stage, brought the currencies of the commercial nations into a stable relation one to another, and re-established a convenient common standard for international payments.

Let us admit that this is a considerable achievement, and ought not to be sacrificed if we can possibly retain it. What, then, does its retention involve? Clearly nothing less than the real equivalence of the paper one-pound note, which we now use for our internal circulation, with approximately the quantity of gold which it is supposed to represent. The surest and easiest way of securing this is to make the one-pound note actually exchangeable, at the Bank of England, for this quantity of gold. That is what is done now; and, further, unlike some other countries which are also nominally on a gold standard, we allow full freedom to anyone who likes to take gold out of the country.

I do not say that these conditions—free exchangeability of notes for a fixed amount in gold and free export of gold—are the only ways in which the real equivalence of our paper currency with gold could be secured. I say, only, that they are the surest ways, and defer for the present consideration of other possibilities. Let us assume, for the moment, that they are to be maintained, and see what follows.

Two things, I think, clearly follow. First, we must be assured of having available a sufficient supply of

gold to meet all actual demands for gold for export. Secondly, we are not free to increase the quantity of notes in circulation to such an extent as to make them, in practice, worth less than their face value in gold. In other words, we are not free to *inflate*, in the sense commonly given to the word.

We must have enough gold to meet all actual demands for export. For, unless people can get gold when they want it for this purpose, it is no use pretending that they can. If we cannot be assured of enough gold to meet all such demands, we must stop pretending and impose restrictions on export. But, clearly, while, under present conditions, we need enough gold for this purpose we do not need any more, at any rate beyond a small cover for possible contingencies.

There is nothing in the gold standard, as a standard of international value, that makes it necessary for us to have a supply of gold equal to, or bearing any fixed proportion or relation to, the amount of our internal note circulation. We need enough to meet actual demands for export; but, as appears so far, we need no more.

Our existing practice, however, compels the Bank of England to keep a great deal more. According to the most recent return, the Bank, despite the heavy gold losses of recent years, had still over £130,000,000 of gold coin and bullion.[1] But over £100,000,000 of this was held as a reserve against notes actually in circulation in the hands of the public or of other banks, and under £30,000,000 was directly at the call of the

[1] This paper was first published in October 1929.

Banking Department of the Bank of England. If this £30,000,000 or any large part of it was lost by way of export, our bankers would think that the end of the world had come, though they had still £100,000,000 safely tucked away as a reserve against the note issue—£100,000,000 which they had no intention of using, and no fear of losing.

My point is that, while we do need enough gold to meet demands for export, we certainly do not, under present conditions, need *for this purpose* anything like £130,000,000; and no evidence has yet emerged of any purpose for which the rest of this vast stock of gold is needed. Do we really need it at all?

Under different conditions we might need it all; but under these conditions it would be of no manner of use to us. Let us suppose that the Bank of England, while continuing to give the public a fixed amount of gold for any bank-note presented to it, were to issue a vastly increased supply of notes, without regard for any consideration either of the amount of gold in its possession or of the needs of the country for currency. Obviously, each note would fall in value and would be worth less in goods than it is now. But if each note were worth less in goods, it would also be worth less in gold, both because gold is a "good" with a worth of its own, and because people could take the gold to other countries, and then buy with it more goods than they could get for a depreciated £1 note in this country.

It is evident what would happen. People would rush with notes to the Bank and demand gold;

and all the Bank's store of gold, however great it might be, would be gone before you could say "Jack Robinson"!

Of course, this could not happen in practice. If the Bank were about to issue so many notes as to depreciate their value, it would begin by prohibiting the export of gold and perhaps by suspending the public's right to change notes into gold as well.

It is clear, then, I hope, that the Bank is not free (and would not be free no matter what laws Parliament might pass) to issue just as many notes as it likes. Limitation of the quantity of notes issued is indispensable if they are to be kept at a stable value in relation to gold; and unless they are kept at this stable value, the benefits of an internationally stable means of payment cannot be fully secured.

What then? Does it follow that our present banking policy is right? By no means. The Bank is not free to issue as many notes as it may please; but it does not at all follow that the number it issues should bear any fixed relation to its stock of gold. The number of notes that can be issued without loss of value depends on the quantity of things that are to be bought and sold, and not on the quantity of gold in the vaults of the Bank. Yet it is on the latter that the Bank's policy is now based, with the result that the quantity of things is largely made to conform to the quantity of money the Bank is prepared to supply. Herein lies the rooted insanity of our present financial system.

III

There were, on October 9, 1929, notes in circulation or issued by the Bank of England to a value of over £390,000,000. To cover these notes the Bank had rather over £130,000,000 of gold coin and bullion, about £5,000,000 of silver coin, and about £255,000,000 worth of securities. In other words, the "fiduciary issue" of notes—the issue not backed by an equivalent amount of gold—was £260,000,000.

Why? Who settled that the Bank should issue notes to an amount just £260,000,000 in excess of its holding of gold and bullion? Why was this amount fixed? Is there some peculiar rightness about it, to ensure that it shall work out to the best result for the community as a whole? The answers to these questions are, I think, somewhat startling, and suggest grave doubts whether our banking policy quite deserves all the respect which it is accustomed to receive.

Who settles the amount of the fiduciary issue? The Bank of England, subject to a maximum limit imposed by Parliament. The Bank cannot, in ordinary circumstances, issue more than £260,000,000 of notes unbacked by gold; but it can, if it chooses, at any time issue less. It can, in exceptional circumstances, and to meet a temporary emergency, issue more, but only if it first asks and obtains the consent of the Government. (Note, in passing, that it must be the Bank which asks the Government. It cannot, under the Act, be the Government that asks the Bank to issue more notes.)

Ordinarily, the £260,000,000 cannot be exceeded; for Parliament only quite recently passed the Act which fixes this as the "fiduciary limit". If the Bank wants to issue more notes to the public, it cannot, therefore, do so in normal conditions, except by getting more gold. There must be a pound for pound gold backing for every additional note. The limit of £260,000,000 is therefore clearly of vital importance. Parliament fixed it in its wisdom, acting on the advice of the bankers themselves. Why? What deep wisdom declared that £260,000,000 was neither too much nor too little, but just right?

Only one reason has ever been given for fixing this particular limit. It was about the amount (allowing for a little play) required in order to keep the total amount of currency unaltered at the time when the Treasury Note issue was taken over by the Bank of England. In pre-war days, when we used mostly gold coins, and notes were relatively unimportant, there was a fixed fiduciary limit of under £20,000,000 (also the result of historical accidents into which it is not necessary to enter here). During the war and for some time after the Government printed Treasury Notes to take the place of gold coins and to finance the hugely swollen expenditure of war. During the war, there was no fixed limit to the number of notes it might print, and the number went on actually growing from year to year.

Soon after the war, however, when prices had reached their peak, it was decided by the Treasury that the largest number of notes actually issued in any year

should be treated as the maximum that might be issued in the following year. The decision had no legal force; but it was acted on, and the number of notes was gradually reduced during the years of falling prices that followed.

Finally, it was decided to hand over the Treasury Note issue to the Bank of England. It then became necessary to decide what limit, if any, ought to be set to the Bank's right to issue notes. There had been, under the very different circumstances of pre-war days, a fixed fiduciary limit. So financial conservatism settled (for no reason that was ever clearly stated) that there should be a fixed fiduciary limit again, though the post-war note issue bore quite a different relation from the pre-war issue to the total currency of the country.

There was, then, to be a fixed limit. What should it be? No one could produce any good reason in favour of any particular figure as likely always to meet the needs of the country. But some limit, said the financiers, *must* be fixed. In a happy-go-lucky spirit that would be ludicrous if it did not so vitally affect the national welfare, someone said, "Oh, what about making the present amount of the fiduciary issue the maximum for the future?" And, because no one could suggest any sound reason for any other particular figure, that light-hearted proposal was adopted.

What did it involve? That all increases in the national demand for currency should be met wholly by an increase in the supply of gold (I am not forgetting that there was an exception to this: I am coming to it in a

moment). Now, trade was bad at the time when the return to the gold standard was made. If trade improved it was certain that, unless prices fell greatly, more currency would be needed to finance the increasing volume of transactions. But it was decreed, on the advice of the financiers, that we should only be allowed to have this extra supply of currency if we could get it in gold from abroad. This decision was made when it was perfectly well known that there was a world shortage of gold, and when more and more countries were trying to get back to the gold standard, and so threatening to make still more severe the pressure on the limited supply.

The Act which handed over the Treasury Note issue to the Bank of England thus did so on terms which made it certain that the future supply of currency would be very inelastic, and that any revival of trade was likely to be checked by a shortage of currency. Indeed, so obvious was this, that the Act, having laid down a fixed fiduciary limit, went on to recognise that it might be impossible not to exceed it, and to enact the provisions already mentioned for allowing it to be temporarily exceeded if the Bank and the Government agreed. But this was an idiotic way out of the difficulty. The truth was that *the fixed fiduciary limit itself was wrong.*

The need for currency depends, not on the amount of gold in the vaults of the Bank, but on the volume of transactions to be financed, and on the currency-using habits of the people. As the latter take time to change, we may say that, over short periods, with which we are here concerned, and under relatively stable con-

ditions, the volume of transactions needing currency is the key to the amount required.

Of course, it is true that any amount of currency can be so used as to finance any volume of transactions. But it can do this only by affecting the price-level. Scarcity of currency forces the price-level down; abundance forces it up. My point is that *at a given price-level*, the need for currency varies with the volume of transactions to be financed.

Presumably, those who wanted a fixed fiduciary limit and also realised that it would be very difficult for this country to increase its stock of gold, held that the needs of an expanding volume of transactions should be met, not by an increase in the amount of currency, but by a fall in the price-level.

This, indeed, is in part, but only in part, what has actually happened. Prices have fallen; and in consequence the £260,000,000 of currency notes not backed by gold now buys more goods than it did when the limit was fixed. But, as we have seen, falling prices also discourage production. The limit has acted so as at the same time to force down prices and to restrict production and cause unemployment and distress.

Is my point now clear? In face of a world shortage of gold, a *fixed fiduciary limit is bound to act as a clog on enterprise*. It is true that, given time, our financial habits may so adjust themselves as to make a fixed supply of currency go a longer way, by cutting out the use of currency for certain types of transactions. But this process takes time. It is practically certain that it has been at work during the past few years, and that it

has caused the results of the fixed supply of currency to be less disastrous than they would have been without it. But it cannot easily be pressed far or fast; and it is quite impossible to rely on it as a means of dealing with the situation.

We need, and ought to have, not a fixed supply of currency, or one variable only within narrow limits according to the ebb and flow of our stock of gold, but a supply proportioned to the needs of industry and trade in relation to the prevailing level of world prices. If we can produce more goods, we need, unless other factors change, more currency in order to buy and sell them at the prevailing prices; and this currency can be put into circulation without exerting any effect on the price-level or on the value of our paper-money in relation to gold. Not our stock of gold, but our productive capacity in relation to the level of world prices is the true guide to the amount of currency which we both need and can issue with safety.

Does this mean that we could with safety issue far more currency than we are issuing to-day? Such a question we are not yet in a position to answer. What it does mean is that we are allowing our currency policy to be decided for us, not by any consideration that is really of the smallest importance, but by one that is wholly irrelevant. The stock of gold we possess is absolutely no guide to the amount of currency we ought to issue.

It is, however, from the false connection between these two things, from the legislative sanction that has been given to this connection ever since Peel's Bank

Charter Act of 1844, and from the structure of business habits that has been built upon this supposed connection by the financial world, that the immense importance attached to our stock of gold is derived. Unless our issue of currency depended on our stock of gold, unless it were made so to depend by law, and unless bankers based their supply of credit upon a supply of currency which in turn is based on a stock of gold, we should only begin to get worried about gold movements if we really feared that we might not have enough to meet export demands. As it is, we are in a dither because we have lost £35,000,000, although we still have over £130,000,000 left.

In the last paragraph I have introduced for the first time a new and vital point. In this paper hitherto, I have been speaking only of gold in relation to currency, and not of gold or currency in relation to credit. But, in our modern economy, it is clear that credit is, on the face of things, at any rate, what matters most. The reason usually given for objecting to a higher Bank Rate is that it involves a restriction in the supply (not of currency, which it does not directly affect, but) of credit, with the aid of which most of the great transactions of modern business are largely carried on.

It has now been suggested, in the last paragraph, that the habits of the financial world have established a close connection between the supply of currency (which depends on gold) and the volume of credit which the banks and other agencies are prepared to allow. In this way the problem of gold is intimately bound up with the problem of credit, and currency

acts as a link between them. We have therefore to look as carefully as we can at the nature of the connection between currency and credit in order to see what light our study of the gold question can be made to throw upon the credit problem.

IV

Most big, and many little, transactions take place nowadays without any direct use of currency in the form of coin or notes. They are carried through by means of cheques or other credit instruments, such as bills of exchange; and for our present purpose we may take cheque transactions as typical. I owe somebody so much money. I write him a cheque, which he presents at his bank. If he and I, as often happens, use the same bank, all that follows is a series of entries in the books of the bank. The sum standing to my credit is written down by so much; the sum standing to his credit is written up by the same amount. No currency changes hands. Even if we bank at different banks, this remains true. All that happens is that the sum standing to the credit of my bank at the Bank of England is written down, and that standing to the credit of his bank written up. Indeed, as the bankers have a common Clearing House through which they set off against one another their respective claims, only the net sum due from one bank to another after this setting off even causes a transfer of credit in the books of the Bank of England.

Thus, the vast transactions that are carried out by cheque do not of necessity involve any use of currency at all, in the form of either cash or notes. It is true that the man to whom I pay my cheque may elect to draw the sum out of my bank in cash or notes, but so may I draw it out myself while it belongs to me. The transfer of my money to someone else need create no demand for currency at all.

It is, however, true that some transactions do still take place in terms of cash or notes. I do settle many small and a few big transactions in that way. And it is true that the larger the total volume of transactions becomes, the larger the demand for actual cash and notes is likely to be. For *some* of the additional transactions are likely to call for the use of currency.

Not all types of transactions, however, have an equal tendency to demand the use of coin or notes. An increase in industrial production commonly does this to a considerable extent, because wages are usually paid and spent in cash, and not by cheque; and increased industrial activity normally means a larger wages bill. An increase in Stock Exchange transactions does not have the same effect, because most of these will be settled by cheque or similar means, and not by the actual use of coin or notes. It follows that, whereas industrial activity cannot easily expand without either an increased supply of currency or a fall in the wage-level, Stock Exchange activity can and does. A restricted supply of currency in itself limits industrial expansion, but not speculative activity on the Stock Exchanges.

The position, however, is more complicated than

this suggests. For both industrialists seeking to expand production and speculators wanting to buy stocks and shares do so to a largc extent by calling on the banks to supply credit—in other words, to lend them the purchasing power, or part of the purchasing power, required. The two forms of activity thus react in the samc way on the demand for credit from the banks, but in different ways on the demand for currency.

Now, in this country, as we have seen, the supply of currency is limited by law. But the supply of credit is not so limited. The bankers, if they think fit, are legally free to lend as much as they like. If they lend more freely to industrialists, for the increase of industrial production, the result will be an increased demand for currency. But the supply of currency is limited, and cannot be increased at will. Accordingly, if the demand for currency threatens to outrun the supply, the Central Bank (i.e. the Bank of England) will at once take steps to correct the position by bringing about a reduction in thc supply of credit. This it can do largely by what are called "open market operations", or, in plain words, by itself buying or selling gilt-edged securities. Every time the Bank of England buys a security, it has to pay the person from whom it buys. Money thus flows out from the Bank of England into the hands of the public and, through them, into the joint-stock banks. The cash reserves of these banks are thus increased, and they are able to lend more freely.

But every time the Bank of England sells a security someone has to pay it. The process is then reversed. Money flows from the public (and through them from

the joint-stock banks) to the Bank of England. The cash reserves of the joint-stock banks are decreased, and their lending power falls.

These are processes perfectly familiar to the banking world, and far more direct in their effects than a change in Bank Rate. Bank Rate is effective largely because the joint-stock banks, of their own will, conform to it, and accept a change in it as a sign that the Bank of England favours either an increase or a diminution in the supply of credit. But the open market operations of the Bank of England are more direct in their effects. The joint-stock banks conform to them because they have to, at any rate when they are so used as to decrease the supply of cash in the banks' hands.

So far, I have spoken as if these operations react equally and alike on all forms of credit, whether it is required for speculative purposes or for increased production. To some extent they do react alike. In both London and New York it is one of the chief difficulties of the Central Banks that they have no real means in their hands of encouraging increased production through easier credit without encouraging speculation as well, and no means of checking speculation without also checking production. The financial history of the past few years provides abundant evidence of the truth of this statement. A change in Bank Rate, or the buying or selling of securities by the Central Bank, reacts in the same way (though not in the same degree) on both speculation and production.

This is a most serious matter; for more production is a good, and more speculation an evil. And the position

is made the worse because, whereas an increase in the supply of credit is usually available for either speculative or productive purposes, a decrease reacts, in the long run, more seriously on production than on speculation. (This is not true in the short run, for reasons which it would take me too far afield to discuss. But, for our present purpose, it is the long run that matters.) If bankers have to decrease credit, this is because they have experienced, or fear, a fall in their cash reserves. But industrial lending has a greater effect than lending for speculative purposes in diminishing these reserves, because it calls for a greater proportionate supply of actual cash and notes. Accordingly, in the long run, credit restriction reacts far more seriously on production than on speculation; and, while restriction is in force, it may tend to divert credit, from financing production to financing speculation in stocks and shares.

What is the result? When the Bank of England sets out to check speculation, it is driven not only to check productive activity as well, but to check it more. And at the bottom of the trouble is the fact that the supply of currency bears a different relation to speculative and to productive activity.

This brings me back to the point suggested at the close of the last section. It is often assumed that there is a fixed relation between the supply of currency and the supply of credit. I do not believe there is. For the supply of currency limits credits for productive purposes, and therefore limits production far more rigidly than it limits the supply of credit for speculation.

Here lies the root difficulty in applying the policy which seems on the face of the matter to be obviously required. Currency and credit, it is often said, ought to be based, not on the amount of gold in the Bank, but on the volume of transactions needing to be financed. On this basis it is often urged that the volume of currency and credit ought to correspond to the volume of production at current prices. But the currency and credit available are applied to the buying, not only of the current production, but of all things that are bought and sold, including stocks and shares and capital values of every kind. Even, then, if there is abundant productive capacity waiting to be used for the increase of the volume of products, it does not follow that increased currency and credit will be used for this purpose. They may serve instead as the basis for intensified speculative activity, leaving the volume of production practically unaltered. There is real danger that this would happen if, to-day, the supply of currency and credit (or of credit alone) were increased, *and the rest of banking policy were left unaltered.* Failure to appreciate this point vitiates many of the schemes that are put forward for curing unemployment simply by making credit more easily available.

Perhaps I can best make my point clear in this way. An increased supply of currency and credit would have no inflationary effect—would not raise prices in general—if the volume of things to be bought and sold grew in proportion to the increased supply. But this statement relates to prices in general—prices of all things bought and sold, and not commodity prices alone. The

flow of credit into speculation does not increase the supply of stocks and shares in the market nearly as much as it raises their prices. Increased credits for speculation therefore do raise prices—prices of stocks and shares. This increase results in large profits for speculators, and gives them increased purchasing power. If they use all this purchasing power in buying more stocks and shares at still higher prices, commodity prices are not directly affected. But in fact they use some of it in demanding commodities. The increased credits, however, have not been used to finance production, and the supply of commodities has therefore not increased. There is more money to be spent on them but their volume is no greater. Accordingly, the prices of commodities also tend to rise. That is largely why, even with abundant productive power available, an increased supply of credit cannot be relied upon either to produce a corresponding increase in production or to neutralise, by this means, the tendency of more money to involve higher prices.

What is the moral? We cannot put into practice a sound elastic credit policy until we have found and applied means of checking speculation without checking productive activity as well. If we are to increase the supply of credit without causing inflation we must secure that the increased credit is used for productive purposes, and does not flow, either directly or indirectly, into speculative channels. In other words, we must control not only the amount of currency, and the amount of credit based upon it, but also the way in which these amounts are applied. This involves

control, not only of the Bank of England, but also of the joint-stock banks.

V

I discussed in the last section the dependence of the supply of credit on the supply of currency available, and the effects of restricted credit in checking production. The chain of cause and effect runs thus. Less gold, less currency; less currency, less credit; less credit, less production. Thus a shortage of gold may be, under present financial conditions, an absolute obstacle to an expansion of production, and may condemn large bodies of men to unemployment. That it must do this, and that there was no way of escape from this effect, appeared to be the main argument behind the Treasury Memorandum on Unemployment issued by Mr. Winston Churchill just before the General Election.

It is, however, easy to draw a wrong conclusion from this damning statement of the working of our present banking system. A shortage of gold can, under present conditions, be made into an absolute barrier to industrial expansion, But it does not follow that, if we ignore gold and issue currency and credit on a different basis, so as to provide enough to finance a higher volume of production at the prevailing prices, this higher level of production will actually be secured. Instead, we may find that production has not expanded, but that the price-level has risen, and there is just as much unemployment as before.

This, indeed, would be the most likely outcome of changing our credit policy, *and changing nothing else*. For, as I understand the position, an expansion of currency and credit cannot be a *cause*, but only a *condition*, of economic expansion. The two things are very different. Credit is an essential condition of production; and, unless it is allowed to expand, production and employment are bound to stagnate. But the mere fact that additional credit, or even cheaper credit, is made available is not a sufficient reason for manufacturers to engage in additional production.

The final regulator of the volume of production is demand. More labour will not be engaged, or more goods produced, unless there is a demand for them. But the readiness of the banks to issue more credits does not in itself create any additional demand. Much nonsense has been talked about the credit system through failure to appreciate this essential fact. It has been argued that a mere increase in the willingness of the banks to create credits will in itself be enough to bring about a revival of industry. But in the first place the additional credits may not be taken up at all, and will not, unless borrowers see the means of making profit by their use. This prospect of profit depends on demand, which is therefore no less necessary than the credit which helps to supply it. And, in the second place, even if the credits are taken up, they may, as we have seen, not be applied to productive purposes.

What follows? Any effective step by the Government to increase the volume of employment and production must include two things at least—the creation both of

an effective demand and of the credits needed in order to supply goods to meet it. If either step is taken without the other, it will not achieve its object.

If, for example, the Government starts large schemes of public work without increasing the supply of credit, the effect will be largely that of diverting employment from one type of production to another, rather than of increasing the total volume of employment and production. This was the element of truth behind the arguments advanced by the Treasury under Mr. Winston Churchill.

If, on the other hand, the Government or the Bank of England increases the supply of credit without starting public works as the means of using it, then either it will not be used at all, or it will be used largely for purposes other than increased production (for speculation, for example, or for overseas investment). In this case too, the volume of employment and production will be little, if at all, increased.

We must, then, consider the credit situation in close relation to other factors in the unemployment problem. Mr. Snowden and the Bank can easily checkmate, if they so desire, all Mr. Thomas's efforts to bring about a revival of industry; but they cannot bring about a revival themselves without Mr. Thomas's help. Mr. Thomas's is, indeed, the prior task; for he has to create the demand for productive credits before they can usefully create the additional supply.

The function of the banking system is not to create production, but to meet the demands of the productive system. That is why a great scheme for the stimulation

of public works is essential to the restoration of industrial prosperity.

But let no one suppose that this means that banking policy is unimportant. On the contrary, it is of vital importance, because, in the short run at least, the banking system has an almost absolute veto on industrial expansion.

This brings me back to the gold question. We clearly need a way of managing our affairs that will secure the employment of our productive resources to the fullest possible extent. The only rational limit to production is the demand for leisure. We do not want to produce as much as we can possibly produce, because we do not all want to work the longest number of hours a day we physically could work at the utmost intensity of which we are physically capable. We want leisure, and, after a certain point, we value leisure above the additional product of further labour. But up to this point we want to see all our available productive resources used to the fullest possible extent; and it is the purpose of any sane economic and financial system to secure that they shall be so used.

This object is clearly quite inconsistent with the regulation of our internal currency and credit by the amount of gold that we are able to secure in the world scramble for it. The supply of gold is both, over the world as a whole, highly inelastic, and, in relation to any particular country's share of the supply, governed by causes which have very little to do with industrial needs. Even, then, if we continue to use gold both as an international standard of value for equating the

currencies of different countries, and as an international means of payment, for settling the balances due from one country to another that are not settled in other ways, it by no means follows that we should also use gold as the regulator of the volume of our internal currency or credit.

This paper is, in relation to our internal affairs, a plea for a "managed currency", as it is often called, or, in other words, for a currency that is regulated not automatically by the supply of gold, but deliberately so as to keep its volume in accordance with the needs of our internal productive system. This, I agree, would involve the use of greater wisdom by those responsible for this regulation than our present banking methods involve; and I shall discuss in the next section some of the principles that would guide them in the task of "managing" the currency.

But the fact that the system would call for greater wisdom than that now in force is not a condemnation of it; for we are at present paying the penalty of refusing even to attempt the application of wisdom to this vital department of our national affairs.

The sole plausible case for an internal currency based on gold is that its regulation is automatic. In order to protect ourselves from the danger of making mistakes, we accept the certainty of making them by the use of a system which we can see to be inherently wrong and inappropriate. It used to be urged, indeed, that the supply of gold in a country would tend necessarily to adjust itself to its economic needs. This was held to be so on the ground that too much gold, by raising prices,

would make it profitable to export gold to a country where prices were lower, whereas too little gold, by lowering prices, would encourage foreigners to send gold here in order to buy things cheap.

This view, however, seems to have been based on the assumption that changes in the quantity of gold and currency would necessarily cause *proportionate* changes in the price-level—a view which cannot possibly survive the test of verification by reference to the facts. Many things besides the quantity of gold or currency affect the price-level; and a shortage of currency may react quite as easily in diminished production as in lower prices. The deflation which accompanied our return to the gold standard had, as many people have recognised, this result.

If, however, the supply of gold in each country does not automatically adjust itself to each country's needs, the case for allowing our internal supply of currency and credit to be governed automatically by the supply of gold falls to the ground. We have to look for a different principle of regulation, and, since no even plausible case can be made out for any other automatic regulator, the search implies the necessity of a "managed" currency. The question is not whether, but how, the currency is to be "managed".

VI

I am now attempting to draw together the arguments of this paper into a conclusion. In the course of it, the

following are, I think, the main propositions that have been advanced.

(1) There are for the present strong reasons for continuing to use gold as a means of international payment; but this does not, and should not, involve the use of gold as a basis for our internal currency;

(2) The supply of internal currency ought to be based not on the stock of gold, but on the needs of industry and commerce;

(3) The same applies to the supply of credit, which need not, however, bear a fixed relation to the supply of currency, as different types of transaction affect differently the amount of currency and credit required;

(4) The right adjustment of currency and credit cannot be secured merely by altering their volume, because, if this is done, credit may flow into speculation instead of production, and so result in higher prices;

(5) It is therefore necessary to control the destination, as well as the amount, of credit, and accordingly to control the joint-stock banks, which are the main granters of credit, as well as the Bank of England, which is the chief regulator of its amount;

(6) The amount of credit should be based, not on the volume of *past* production, but on the amount that *can be produced* under reasonable conditions with the productive resources available;

(7) This, however, cannot be secured merely by making credit cheaper, or available in larger volume; for the ultimate source of production is demand, and, unless demand is increased, the effective supply of credit for production cannot be increased either;

(8) It is therefore necessary for the Government to take steps to create a demand for increased production, at the same time as it takes steps to make available the larger supply of credit which increased production requires. No mere policy of credit manipulation will remedy unemployment;

(9) It is no less true that all attempts to remedy unemployment without increasing the supply of credit are doomed to failure;

(10) An increase in the supply of currency and credit, unaccompanied by a corresponding increase in production, is inflation, and is bound to raise prices. But a parallel increase of money (currency and credit) and production (goods and services) is not inflation, and has no such tendency;

(11) The retention of the use of gold for external payments involves the convertibility of internal currency into gold at a fixed rate, as at present, and therefore the maintenance of an internal price-level in equilibrium with the world-level of prices ;

(12) This necessity excludes any policy involving inflation, but does not exclude an increase of currency quite apart from any increase in our stock of gold, under conditions which will not lead to inflation;

(13) We need enough gold to meet possible demands for it as a means of external payment, but we do not need any gold at all as a basis for our internal note circulation, which should be "managed" wholly without reference to the supply of gold, but in close relation to (*a*) the world-level of prices, and (*b*) our internal productive capacity.

(14) We should therefore (*a*) socialise the Bank of England, (*b*) socialise the joint-stock banks, (*c*) repeal the clause in the recent Bank Act which fixes the fiduciary limit for the issue of currency, (*d*) cease to worry about gold movements except as they may affect our ability to meet international payments.

These fourteen points give the gist of the arguments which I have advanced in this paper. They lead irresistibly to the conclusion that we need to rely in the future, not on gold movements as an automatic regulator of currency and credit, but on "managing" both currency and credit in relation to the needs of our own economic system.

This, I must make clear, is not a proposal that we should substitute anything else for gold as an automatic regulator. This has been suggested; but I am not advocating it. It has been proposed, for example, especially by American writers, that the supply of currency should be automatically governed by the movements of wholesale prices, and should be varied in such a way as to keep the internal level of prices practically unvarying. It is, however, impossible to stabilise internal prices in this way unless we are prepared to allow the rates of exchange to fluctuate widely. It is not within our power, as a single country, to stabilise world prices; and, if we stabilise our own price-level while world prices continue to fluctuate, this can only mean that the value of our money must fluctuate in terms of the moneys of other countries. A well-known American plan for "stabilising the dollar" recognises this, and proposes that the dollar should be

fixed in internal purchasing power, but should be exchangeable for varying amounts of gold, or, in other words, for varying amounts of the currencies of other countries as measured in gold. This might be possible for the United States, as their home market is vastly more important than their position as an international centre; but it is hardly possible for us, with our dependence on world commerce and our position as a centre of world finance.

The policy which I have advanced implies, on the other hand, foreign exchange rates stable within relatively narrow limits; and this involves the possibility of fluctuation in internal prices. My proposal is not one for the stabilisation of internal prices. This is not because I believe price stabilisation to be unimportant, but because I believe it to be essentially a matter for international action, and one with which we, as a single country, cannot hope to deal.

It is important for currency reformers to understand that they cannot, by national action, have matters both ways. They cannot have both internal price stabilisation and stabilised rates of international exchange. They can have either on conditions, but not both. The question is which is to be preferred.

I prefer exchange stability, which makes our internal price-level dependent on the movement of world prices, first, because I regard it as a first step towards international price stabilisation and secondly because I believe its undoubted benefits to us as a centre of world commerce and finance can be combined with the benefits of an elastic internal system of currency and credit.

This elastic system, however, cannot depend on any automatic regulator. If a managed system of currency and credit were adopted, it would mean the need for a constant exercise of judgment by those responsible for the control of the socialised Bank of England and the socialised joint-stock banks.

Above all, our bankers, under the suggested system, would need to be constantly as well informed as possible, not only about the actual course of production and employment, but also about the productive capacity lying unused, the new means of production coming into existence, and the conditions under which production could be increased. They would need to ask whether, in this or that line of business, higher production would mean higher or lower costs, how it would react on imports, to what extent the demand for the products that could most easily be supplied in greater quantity could be expanded, what indirect demands for credit any expansion in this or that line of production would be likely to create.

In short, a "managed" financial system involves also a national planning of productive effort. It means more and better figures about the course of industry and trade, far more publicity among business men about their productive plans and methods, and far more control over the course of production by the socialised banks as agents for the distribution of productive activity among different industries and services. It also involves a control of the use of capital as well as credit; for to a great extent the supply of capital and credit must go together.

It may be said that these are tasks too difficult for any body of men to undertake, and that we had better stick to gold as a regulator because it at any rate saves us the use of our brains. But the task is not really so difficult as this criticism suggests. Most of the necessary information either is available, or could readily be made available if we set out to make it so. With such information as could readily be placed at their disposal, I believe that a reasonably intelligent commission of financial control could "manage" the currency for us, not with perfect efficiency, of course, but with far less disastrous results than follow from our present reliance on gold as an automatic regulator of our financial affairs.

Further discussion of these points would, however, take me too far afield from the main purpose of this paper. Even what I have written serves to show how little it is possible to isolate the gold question from the problem of credit, and how the credit problem is bound up with the entire structure of the productive system. There I must leave the matter, in the hope that the issues which I have raised will be really considered by Mr. Snowden's Committee on the banking system, and that the ancient habit, so carefully fostered by City and banking opinion, of regarding the gold question as a sacred mystery which laymen cannot hope to understand, will at last receive its *quietus*. Gold and the City have ruled us all too long.

III

THE GOVERNMENT AND THE UNEMPLOYED

Reprinted from *The New Leader*,
December 1929–January 1930

III

THE GOVERNMENT AND THE UNEMPLOYED

I

It is now being freely said, by Liberals and others, that Mr. Thomas has failed to solve the unemployment problem. The Labour Party, it is said, got votes at the General Election because it not only, like Mr. Lloyd George, promised to take drastic measures to deal with unemployment, but also seemed likely to carry its promise into effect. Labour has now been some months in power and Mr. Thomas has been specially set aside as "Minister of Unemployment", with Mr. Lansbury and Sir Oswald Mosley to help him. But what sign is there that the problem is being solved, or even that a solution is being seriously attempted? The Liberals and Tories are openly scornful of Mr. Thomas's efforts; and—what matters far more—Labour opinion is restive and dissatisfied and, while it is anxious to do nothing to embarrass the Government in its task, increasingly doubtful whether after all the hopes entertained a few months back are likely to be fulfilled.

In these circumstances, it is well worth while to attempt a careful survey of the problem, and especially of the obstacles which Mr. Thomas and his colleagues have encountered so far in their efforts to deal with it. For we want to know whether the jeers of opponents are really justified, and whether Mr. Thomas is in fact doing all that can be done to redeem the pledges which Labour gave at the General Election.

First, a word about these pledges themselves; for there is a good deal of misunderstanding about them. It was not the Labour Party, but Mr. Lloyd George who promised, if returned to power, to reduce unemployment to insignificant proportions within a year or two at no real cost to the nation. Mr. Lloyd George could afford to be reckless, because there was no chance of his Party coming back to power. Labour, with the prospect of office before it, was far more careful, and promised no more than a real and determined effort to grapple with the problem. But undoubtedly a great many people voted for the Labour Party in the faith that it would make this effort with all the forces at its command. Labour is not pledged to cure unemployment by any sudden and complete cure; but it is pledged to the fullest extent to try its hardest.

Is Mr. Thomas doing this? Within his present lights, I have no doubt that he is. Probably, he is working hard, and feels the consciousness of virtue because he is doing so. In that sense, he is doing *his* best; but is his best the best the Labour Party can do? If it is, then for some time to come the outlook for the unemployed is gloomy enough to give us all cause to think again.

Let it be understood that I am not complaining at all because Mr. Thomas has not yet been able to diminish the number of the unemployed. In the time he has had so far, nobody could have done much. Even if from the moment when he assumed office he had been laying well and truly the foundations of the best possible policy, no sensible person could expect

much to have come of his plans as yet. It takes time to get things going; and it may even take longer to get them going in the right than in the wrong way. When Tories or Liberals quote against Mr. Thomas the fact that the number of the unemployed has actually risen since his assumption of office, he has a perfectly valid answer. The increase that occurred during the first few months was purely seasonal. While the grave addition to the numbers of the unemployed which has taken place more recently is acknowledged to be part of a world-wide depression, which set in with the crisis in the United States, and has since, in varying ways, spread to nearly all the leading industrial countries. Clearly, the present high figure for unemployment is not due to anything that Mr. Thomas has done. Nor, on the other hand, has he yet done much towards reducing it.

In the main, however, it is clear that there has not yet been time for Mr. Thomas's policy to have much effect on the figures either way. All his plans, whether they are to be operated through the local authorities or through the railways or other private undertakings, are bound to take time to get under way; for proper plans have to be prepared and passed, and even when work is started it seldom employs at once a full complement of labour. It is merely silly to jeer at Mr. Thomas because he has not already succeeded in providing work for any considerable number of the unemployed.

Any sound criticism of Mr. Thomas's policy must proceed on quite different lines. Not his failure to have provided work already, but his failure—if failure

it be—to hold out any reasonable hope that it will be provided in the future is the real ground of objection to what he is doing and leaving undone. If I am setting out in this paper to criticise Mr. Thomas, I am doing so entirely on this basis. I am dissatisfied, not with the results he has so far achieved, but with the steps which he has outlined as the basis of his policy for the future.

I disagree indeed—and I think many other Socialists disagree—with his fundamental assumptions. If I have understood rightly the speeches in which he has expounded his policy to the House of Commons, he holds that jobs cannot be found for the great majority of the unemployed *except as a result of the revival of industry*. I hold, on the contrary, that jobs can and must be found for most of the unemployed *before we can expect industry to revive*. Mr. Thomas is trying to revive industry in order to provide more employment: I want to provide more employment in order to revive industry.

This difference of attitude is fundamental. If Mr. Thomas is right, attention must be directed mainly to the improvement of productive efficiency, especially with a view to the recovery of the export market; and the main body of the unemployed can hope for regular work only at the end of a period of years during which industry will have undergone a thorough reorganisation, and even then only if our efforts to build up a large and rapidly expanding market for exports are crowned with success. For clearly, if the unemployed are to remain on the "dole" while these

measures are being carried into effect, it is futile to look for any great expansion in the home market. Indeed, the need to recover export markets is likely to operate as a powerful factor in keeping wages low, and accordingly in checking any tendency of the home market to expand. Prosperity and employment are to come through selling more of our products abroad; and hope for the unemployed is to be postponed until measures for the reorganisation of industry—by rationalisation and re-equipment—have had time to take effect.

If, on the other hand, I am right, the task of employing the unemployed has to be confronted here and now. This does not mean that I underestimate the importance either of improving productive efficiency or of regaining the place which we have lost in many of the markets of the world. I agree fully that the increase of our foreign trade and the re-equipment of industry so as to make it more productive are indispensable parts of any sound policy for the prevention of unemployment. But at the same time I hold that these measures alone are wholly inadequate to solve the problem. There is no real prospect of so vast an increase in overseas demand as will serve to absorb the main body of the unemployed; and the very measures of rationalisation which are necessary to the recovery of our markets abroad will cause a given amount of goods to be made with less labour, and so create the need for still further expansion if fresh unemployment is not to follow. If, meanwhile, purchasing power is depressed by low wages and no

wages in the home market as well, I see no possibility that this policy can ever work out so as to prevent unemployment from continuing indefinitely.

There is a second reason, no less cogent, that makes me reject the idea that we must await the revival of industry before we can find work for the main body of the unemployed. That reason is, simply, that unemployment wastes and destroys men, body and soul. It is merely intolerable to acquiesce in its continuance on a large scale for years ahead unless we have absolutely no means in our power of preventing it. The man who suffers from prolonged lack of employment not only suffers—and his wife and children with him; he also becomes steadily less capable of good and productive work even when employment becomes available. He deteriorates both as citizen and as producer; he brings up children who are worse fed and worse equipped than the children of men in regular work. If his old trade is one in which he cannot be re-employed, the longer he is left idle the harder will he find it to learn a new one; and prolonged unemployment is especially disastrous in the case of young men and women who lose by it their chance of learning to be useful citizens, and by whose loss the community suffers a heavy loss of future productive capacity.

If by any means we can set the unemployed to work here and now, it is intolerable and inhuman not to do it. The chief ground for my dissatisfaction with Mr. Thomas is that he appears, for practical purposes, to have accepted the view that we cannot find work here and now save on quite a small scale.

I believe we can and should; and the main purpose of this paper is to suggest how the thing, difficult as it appears, can none the less be done, if we have but the will to do it.

II

There are two good reasons, either sufficient in itself, for a determined effort to find work for the unemployed here and now. The first is that it is humanly intolerable to leave the unemployed any longer in their present plight, and utterly wasteful to support them—however meagrely—with unproductive doles drawn from the incomes of the rest of the community. The second is that, if we put the unemployed back to work at reasonable wages, their purchasing power will be a very great factor in stimulating demand, and so bringing about a revival of industry. There is no dispute about the desirability of doing this, or the inherent superiority of a policy of work for all over a policy of doles. The only question is whether the thing can be done.

I do not mean to suggest that Mr. Thomas is doing nothing at all towards the provision of work. Already, in a few months, he has begun to do more than Mr. Baldwin and his Tories did in all their five years of office. He has, I know, speeded up the action of the Unemployment Grants Committee, and relaxed the conditions on which local authorities can obtain grants through it for approved schemes of work. He has set up a new Committee under Sir Arthur Duckham to recommend grants to public utility service under-

takings; he has stimulated the railways into more active schemes of development, speeded up road work, extended the application of Trade Facilities and Export Credits and done many other things designed not only to provide more work in the present, but also to aid in the restoration of productive efficiency for the future. These things which he has done are good things, and Mr. Thomas and the Government deserve all credit for them. But the fact remains that all of them together are not likely to make any very noticeable impression on the total numbers of the unemployed.

The problem is, in fact, far too vast to be disposed of by any conceivable expansion of the projects which Mr. Thomas has so far advanced. He evidently recognises this himself, and makes no claim that these or any similar schemes that may follow them will do more directly than diminish by a little the number out of work. It is to their indirect and long-run, rather than to their direct and short-run, effects that he seeks to draw our attention. They are, to his mind, primarily measures designed to restore industrial efficiency, and only in the second place emergency steps for the immediate provision of employment.

The question is whether something of quite a different order can or cannot be done to set the unemployed, or most of them, speedily to useful work. Those who say that it cannot, appear to base their arguments chiefly on one of two grounds. Either they claim, as the Treasury claimed in a famous memorandum issued on the eve of the Election, that any pro-

vision of work by the State will only tend to turn an equal number of persons out of employment elsewhere; or else they urge that the provision of work is too costly, and that the nation simply cannot afford to find the money. With the first of these two arguments I need not now attempt to deal. I discussed it incidentally in the course of my paper on the Gold Question; and, in any case, Mr. Thomas is hardly to be suspected of holding it, and it has been answered over and over again, both by Liberals like Mr. Keynes, and by spokesmen of the Labour Party. It is true only if the banks refuse to expand credit, and I hope we may take it that if Mr. Thomas were being held back by any such refusal, he would not have sat down quietly under it, but would have told the country his difficulty, and called in both Government and people to bring the bankers to book.

Is the trouble, then, that there is no money available? Is Mr. Snowden, rather than Mr. Thomas, the real imposer of a veto on any ambitious plan for the immediate provision of work? I have no idea; for matters of this sort are discussed behind the scenes, and do not find their way into open debate. If it is so, there is no difficulty in appreciating Mr. Snowden's position. Mr. Churchill, during his tenure of office as Chancellor of the Exchequer, managed to lay hands on every easy source of revenue that could be got at without increasing the burdens of taxation. He left Mr. Snowden with a cupboard swept bare, and a growing family of public obligations to be fed. Additional resources for any purpose, unless they are to be

raised by loan, can be got only by imposing fresh taxation that is likely to be unpopular with considerable sections of the public. And even if Mr. Lloyd George's advice were followed, and the whole expenditure for the provision of employment met out of loans, the raising of the money would not be easy in face of the uncomfortable conditions under which the money markets of the world have been suffering of late.[1] Indeed, Mr. Snowden might well have argued —as he very likely did—that a big conversion loan of the kind that has just been raised had to take precedence of any development loan that Mr. Thomas might desire. Perhaps Mr. Snowden's recent loan was intended to clear the way for a big national development loan in the near future. I most sincerely hope it was; but there is no sign as yet in Mr. Thomas's proposals of any policy likely to call for the raising of such a loan.

I am not suggesting that the whole cost of any scheme for the provision of employment could properly be raised by way of loan. The only sound policy, I think, would be to meet by loan such expenditure as would be definitely and directly productive of an equivalent return in the future, and to meet all other expenditure out of taxation. In other words, in so far as employing men now involves employing them at a definite economic loss, the taxpayer must be prepared

[1] The situation in this respect has, of course, changed radically since these words were first published. As I have pointed out in my opening essay, Mr. Snowden has now a quite exceptionally favourable opportunity of raising money for the provision of employment on very easy terms.

to foot the bill. But a substantial part of the total cost of any sound scheme of employment could reasonably be met out of loans.

Of course, this expenditure would not be a net new burden on the taxpayers. Indeed, it might very possibly before long involve no burden at all. If we give men work at wages, we shall not have to give them unemployment benefit or poor law relief; and the sums now spent in this way can be applied to meeting the cost of providing work. No longer will the Unemployment Fund have to borrow, or receive subsidies, from the Exchequer; and no longer will the plight of the distressed areas be made worse still by the burden of supporting their unemployed. The cost of finding work is by no means, even directly, a net cost. And indirectly it is likely to be a source of very great gain. For it is really ridiculous to suppose that it is cheaper to maintain more than a million men in idleness than to pay them rather more for useful work.

Nevertheless, the policy of finding work does involve immediately an additional outlay; and I fully admit that Mr. Snowden will not find it easy to procure the money, in addition to his other commitments. But I do not believe that it cannot be found. I am not a rich man, and like others, I sometimes grumble at the taxes I have to pay; but I know I could well afford to pay more, and I would gladly pay more in order to get the unemployment problem courageously handled. There is more to be got from income tax on the higher ranges of income, from the surtax, from the taxation of land values, and, above all, from the

more drastic limitation of the right of inheritance. And, for the part of the money that is to be raised by loan, Mr. Snowden's recent experience affords ample evidence that there is no real shortage of capital in the country; and there is no reason to suppose that, in a few months' time, the State could not raise a great development loan on terms at least as favourable as those of the recent issue.[1] There is no dearth of capital in the country; and, as at present very little of it is flowing into the development of British industry through the normal channels, the present is a very good opportunity for the raising of money by the State for application to the uses of industrial re-equipment and social reorganisation.

The money can be found, though Mr. Snowden would doubtless rather not have to find it. Obviously, no one likes being taxed; and, no less obviously, our heavy War Debt makes it harder for the State to raise fresh loans, for however excellent a use. But we cannot afford to allow these difficulties to overwhelm us. The taxable capacity of the country, and its ability to find new capital for the development of industry, depend at bottom upon the man-power of our people; and it is merely ridiculous and self-destructive to allow that man-power to rot unused. If we are short of money, it is because we are not using the productive power which we possess. If by better use of the money we have, we call that productive power into play, the extra product thus secured will amply pay us back.

[1] It could now raise the money on easier terms, especially if this were done partly by short-term borrowing.

If, then, Mr. Thomas is frightened of Mr. Snowden, and Mr. Snowden of the taxpayer or the financier, let them both take heart of courage. They will have behind them, if they will seriously tackle this problem of finding work, the overwhelming support of public opinion. The whole Labour Movement will be with them; for, with shrewd common sense, the Labour Movement refuses to believe that it can be more economic not to produce wealth that is clearly needed than to produce it. But, if work is to be found, new methods will be needed. No mere development of Mr. Thomas's present methods will absorb more than a tiny fraction of the unemployed. What are these new methods to be?

III

A new method, I have urged, is needed, based on a fundamentally different approach to the whole problem of unemployment. I should like to see Mr. Thomas not merely considering how many men he can induce local authorities and private employers to engage in return for various forms of loan, or grant, or guarantee, but screwing up his courage to make, on behalf of the State itself, a definite offer of useful work to every unemployed worker, or at least to every man who has been long out of employment and has little chance of early re-engagement in his own trade. In other words, I want Mr. Thomas to regard the unemployed as a great source of useful productive capacity, and to undertake himself the task of setting

to work those for whom no work has been found in other ways.

Unemployment is a national misfortune; but it is also a national opportunity. There is so much useful work crying out to be done—so much work that private capitalism neither has done nor is ever likely to do of its own accord. In case there are sceptics who doubt this, let me cite but a few outstanding instances of work, not merely useful in itself, but also certain to add to the productive efficiency of the country. I shall attempt no exhaustive enumeration; but even these few instances will serve to show that there would be no fear of useful jobs running short, even if the State had, by the methods I shall suggest, to find work for a million men for the space of a whole generation.

Slum Clearance.—In the past ten years we have built many houses; but with all our building we have not even made a beginning with this vital task. Our cities are still full of houses, even of whole districts, that are quite unfit to be the habitations of human beings. The local authorities are much too fully occupied with the task of housing new claimants for dwellings to have time or money for that of clearing out the slums. The Government, we know, is about to introduce a Bill that is to deal with this matter, among others. If it is rightly framed, it can do more than any of Mr. Thomas's schemes to provide work for the unemployed. But it will not achieve this if Mr. Greenwood is driven to trust to a mere policy of partial grant aid to the local authorities. The need

is for a national effort to clear the slums and to re-house the slum-dwellers in new and healthier conditions. The labour is ready and waiting. There are many thousands of actual building trades operatives out of employment; and, if these run short, a great deal of the work of re-housing, as well as most of the work of clearance, could be done with less skilled labour, especially if suitable training were provided and full use made of those methods of building which need the smallest proportion of skilled craftsmen. "Weir houses", I hear someone say with scorn, as if that disposed of the matter. Why not "Weir houses", if need be, provided only that they are built under fair conditions of labour? But in fact there are greatly superior types of houses and other buildings that could be erected with the aid of a comparatively small body of skilled workers. Will not the building Trade Unions object? I doubt it, if they are given a reasonable guarantee of employment for their members; for they have suffered enough under Mr. Neville Chamberlain from the effects of building less houses to raise objections to the policy of building a great many more.

I want, then, a great national scheme of slum-clearance to be carried out under the direct auspices of the State, free of all cost to any local authority that, having an approved housing scheme of its own, chooses to invoke in addition the State's help. And on such a scheme it would be easy to employ a far larger number of workers—after suitable training, of course, where it is required—than all Mr. Thomas's present schemes put together are ever likely to absorb.

SCHOOL-BUILDING.—The Government has decided to raise the school-leaving age in 1931, and local authorities and voluntary school managers are being asked to get ready not merely places for the larger number of scholars, but improved accommodation of a new type for all children over eleven years old. It is now being suggested that this cannot be done because the required new buildings cannot be got ready, or existing schools improved up to the new standard required, in the time available. Here then is a clear case for an emergency scheme of work. Let us use the unemployed to build the new schools that are needed, adopting, as far as is possible without sacrificing efficiency, simplified methods of construction that will need the smallest amount of highly skilled labour.

WATER SUPPLY.—A water-famine, especially in the rural areas, seems to have become a regular visitation in the summer months. Yet there is water to be had, if we will but take steps to make it available. Why not a great national scheme of water supply organised by the State and executed by the labour of the unemployed?

LAND DEVELOPMENT.—At present, as everyone knows, much of our land badly needs draining. Let the unemployed drain it. River-beds need clearing and deepening. Let the unemployed set about the work. Most of the County Councils, consisting chiefly of landlords and farmers, have done little enough to provide small holdings, even where there has been a keen local demand. Let us have a national scheme of

land reclamation and improvement, designed to provide, directly under the auspices of the State, an ample supply of well-equipped small holdings for all *bona-fide* claimants. Few things are so important as the increase of our home production of foodstuffs and the re-scttlement of workers on the land. I am not suggesting that these new recruits to the farming community should set out to grow wheat. There is ample scope for them in producing poultry, eggs, bacon, butter, cheese, market-garden produce—foodstuffs for which, taken together, we pay a great deal more to foreign producers every year than we pay for wheat. The County Councils, for the most part, will not take this task in hand. The bigger farmers do not want to see it done. They do not want the competition of the small producer; and they fear the results of giving to the labourer the means of independence. But here both on the holdings when they have been made ready, and in making them ready for occupation, is work for a large number of men who are now unemployed.

Canals and Ports.—We have let our canals go to ruin, partly because the railways, fearing their competition, have put many of them deliberately out of action. Many of our ports—in South Wales, for example—badly need development in order to equip them for modern shipping and to lower the costs of handling goods in transit. Both these jobs need to be tackled nationally, and it would pay the State to tackle them, though it might not pay the private employer; for the State is interested in indirect as

well as direct returns on what it spends. Both are capable of providing a large amount of useful employment, and neither is at all likely to be taken in hand by any agency other than the State. Why not use the opportunity of unemployment to build up-to-date docks and harbours here in England, and not only in Palestine or in Singapore?

Social Amenities.—Great Britain is cluttered up to-day with the *débris* of derelict capitalism. Dead factories, old slag-heaps, all sorts of dirt and squalor abound in many of our industrial areas. Why not use the unemployed to cart all this refuse and rubbish away, to clear sites for development, to lay out parks, playing fields, and open spaces, to wage war on the ugly, the sordid, and the pestilent—in a phrase, to give Great Britain a thorough spring-cleaning, the first she has had since the Industrial Revolution? Anyone who walks through the back streets of our great towns knows how sorely many of them need a coat of paint. Why not let the unemployed paint them?

Of Roads, of the speeding up of Railway and Electrical development, of Afforestation, of the prevention of Coast Erosion, and of countless other forms of work that need doing, and that the unemployed could well help to do, I say nothing here, because enough has been written about them already. There was much good sense, combined with a good deal of exaggeration, in Mr. Lloyd George's famous road scheme; and it would be mere folly to be prejudiced against it simply because it was used as a Liberal election cry. But I have chosen, in this paper,

to stress rather those projects that are often ignored than those which are commonly placed in the forefront. Mr. Lloyd George went wrong in placing too many eggs in one basket. I think I have shown that there are plenty of baskets available.

In face of the opportunities put forward above, can anyone seriously suggest that there is not an abundance of useful and suitable work waiting for the unemployed to do? The suggestion is patently absurd; and it is only because we are so lacking in imagination that we fail at once to realise its absurdity. Every student of public health knows the terrible loss of both happiness and efficiency that is bred of squalor and insanitary living conditions. How much should we not gain, in material wealth as well as in welfare, if we made use of the present opportunity for a serious onslaught on these old enemies of the human race! On the one hand, we have about a million and a half of men and women waiting for work; on the other, an inexhaustible supply of useful work waiting to be done. Are we really so incompetent as to be quite unable to bring the two together?

IV

Work, then, work in plenty, is waiting to be done; but Mr. Thomas cannot yet make up his mind to take the plunge that will change the possible into reality. It is safe, I think, to suggest that there are two main reasons for his hesitation. He lacks imagination; and

he fears the cost. He has not been able as yet to picture to himself the great change that would come over the face of Great Britain if this long nightmare of unemployment were brought to an end. Relief works, he has been told again and again, are uneconomic and unproductive; and what save relief works can the State provide in face of the failure of ordinary commercial demand?

State production, it is suggested, would only compete inefficiently with private industry; and the men engaged upon it, regarding their labour as a "task", would work ill and grudgingly. It is true enough that often in the past relief works have failed for precisely this last reason; and they will fail again, if they are applied in the old bad way. But I do not believe that all public works executed by the unemployed under the auspices of the State are bound to fail. I think it all depends on the way they are organised; and I believe the plan which I am about to outline is free from the objections usually brought against relief works of the traditional kind. That the plan will involve substantial immediate expenditure I do not attempt to deny; I only suggest that this expenditure will bring back a far more than equivalent return.

What then, in precise terms, ought Mr. Thomas to do—in addition, that is, to what he is doing, or projecting, already? He ought, I suggest, to make a definite offer of useful employment to every unemployed man who has no speedy prospect of finding work in the ordinary labour market. This, evidently, involves the building up, by the State itself, of a great

emergency organisation for the execution of some of the national productive services outlined in the last section. There are narrow limits to the amount of employment that can be found through the local authorities: if we want a scheme that will effectually absorb the unemployed the organisation must be created and maintained directly by the State itself. For the local authorities in the areas where unemployment is severe cannot find the money for large schemes; and the local authorities in other areas do not see why they should pay for maintaining the unemployed of the distressed districts. Moreover, much of the work that most needs doing cannot well be organised under local authorities, whose areas and functions are not suitable for it. The need is for a direct national scheme, organised and controlled immediately by the State itself.

In the fuller description which I have given of this proposal elsewhere,[1] I have called the organisation that I want to see created a "National Labour Corps". I want every unemployed man, unless his lack of work is purely temporary, to be given the opportunity of enrolling voluntarily in a body organised in order to carry through those great works of national improvement which Capitalism persistently leaves undone. I want enrolment in this body to be purely a matter of choice, and no man to be deprived of unemployment benefit or any other payment because he does not join it. And I want the administrators of the Corps to

[1] In my *Next Ten Years in British Social and Economic Policy* (Macmillan).

have absolute discretion to dismiss a man whose work in it is not satisfactory, provided that such a man then resumes his right to unemployment benefit or relief unprejudiced in any way by his dismissal.

These two safeguards—absolutely voluntary enrolment and full rights of dismissal—I regard as indispensable in order to prevent work in the Corps from being regarded, by some of its members, as mere "task work", done in return for a form of relief. The Corps will succeed only if those who join it regard it as an opportunity of doing useful work on behalf of society, and set out accordingly to give of their best.

To skilled men employed on the work of the Corps I would pay, of course, standard Trade Union rates of wages. For the less skilled workers there should be a standard rate specially fixed, and not lower than the rates paid in ordinary employment for work of a comparable sort. Elsewhere, I have suggested not less than forty shillings a week, *plus* allowances for children; but, if no allowances were paid, the rate would clearly have to be higher. Whatever the precise figure may be, the rate should be comparable with those paid in industry generally; for an essential part of the plan is to restore the purchasing power of the unemployed, and so increase the demand for goods and help towards the revival of industry generally.

This Labour Corps, I suggest, should be a mobile body of workers, acting directly under the orders of the State. It should be ready to undertake any and every form of useful work of national development that is not being undertaken by existing agencies. If

we decide to proceed with the Severn barrage or the Channel Tunnel, the Corps should do all the work that does not call for a high degree of special skill. It should make an offer to every local authority to carry through, free of direct charge to the authority, any useful work of development that the authority may suggest, subject, of course, to approval by the agency set up by the Government to scrutinise such proposals. It should, for example, be ready to consider any plan of slum clearance put forward as a supplement to existing housing schemes, or any plan for the building of new cities on the lines of Welwyn, or for afforestation of waste lands, or for drainage and land improvement.

Moreover, it should become especially the agent of schemes of regional, as distinct from purely local, development where, as often happens, such schemes are held back by the absence of any regional authorities in our existing system of Local Government.[1] It should be prepared to take in hand the improvement of our canals, and the bringing of ports and harbours into line with modern needs. It should take over, especially in areas where backward County Councils are not prepared to tackle the problem, lands that are not being productively used to-day, and equip them

[1] The recent report of the Greater London Regional Planning Committee affords an excellent illustration of the sort of work I have in mind. If its proposals were carried out work could be at once provided for a large body of men in making parks and playing-fields, and in similar activities. And almost every big city has, in its degree, problems comparable with those of Greater London.

adequately as small-holdings in order to increase our home-grown supply of food, and so diminish in some measure our dependence on foreign imports.

There are, as will appear later on, yet other tasks than these in the rebuilding of Great Britain that a National Labour Corps is admirably fitted to perform. But here we have at least fully enough to begin upon. It would not be necessary for Mr. Thomas to begin with the full scheme I have outlined. He might, first of all, restrict enrolment in the Corps to men from the depressed mining areas, who have, it may be noted, a special suitability for many of the types of work proposed. Enrolment could be further limited, at the outset, to young men, who are the most easily adaptable to different jobs, and the least deeply rooted in any particular locality. For the National Labour Corps is, above all, the real way of bringing about that "industrial transference" of which so much has been heard. It will transfer men, not so as to do other men out of jobs, but to useful jobs which have been created for them by the State.

Of course, a scheme of training forms an essential part of the plan. Those who have been long unemployed and half-starved cannot be expected at once to give really efficient work. The tragedy of many of the unemployed to-day is that, on account of war service and post-war depression, they have never had the chance of settling down to learn a trade. That is one of the most serious difficulties in the way of their re-employment. A man who enrols in the Labour Corps, and needs time to regain his strength, could

be put at once on full wages and to light restorative work or training designed to fit him for his new tasks. The Corps is intended to be a means not only of finding work to tide men over the present emergency, and not only of using the opportunity which unemployment presents of giving Great Britain a good spring-cleaning, but also of increasing productive power by making each worker who joins it a more efficient producer.

Here, then, in outline is the plan on which I should like to see Mr. Thomas set to work. It is, as I have described it, purely an emergency plan. By reviving the purchasing power of the unemployed, it would go a long way towards stimulating a revival of industry, and so both pay for itself and bring itself to an end through the reabsorption of the unemployed in regular work. I do not put it forward as the only way of tackling the whole problem, or as in itself a sufficient cure for the disease. But as a part of the remedy, it seems to me indispensable; for the first step is to get the unemployed quickly back to useful work, and to recreate their efficiency as producers. And of doing that I know no other way. Does Mr. Thomas know any other? If he does not, will he not at least give this way a trial?

V

The problem of unemployment has two parts. There is the immediate problem of getting the unemployed back to useful work; and there is the underlying

problem of bringing about a secure and lasting revival of industry. In the previous section of this paper I have been laying stress above all on the first of these two problems; but I fully recognise that the latter is, in the long run, by far the more important. For, while we cannot afford to let the unemployed run to seed for lack of useful work and training now, neither can we afford to go on finding work for them—or rather finding the money for such work—unless we can take steps that will bring about a real revival of industry. If I have stressed so far mainly the immediate problem of finding work, I have done so because I think there is danger that this part of the question will be ignored, and not because I am blind to the fundamental importance of industrial revival.

Industry as a whole is depressed to-day chiefly because we have failed to adapt our industrial system to changing needs. For generations past our industrialists and statesmen have been used to thinking in terms mainly of foreign markets. Great Britain won, in the early days of the Industrial Revolution, a pre-eminence in foreign trade which she has come to think of as hers by right of nature. In the supply of cottons and woollens, of iron and steel, of railway plant, ships, and all manner of engineering products, our manufacturers long held almost unchallenged pride of place in the markets of the world. We were great coal exporters when the coal of other countries seldom crossed the national frontier.

Even when Germany and America entered the world market in competition with us, we were able

to make good by finding new areas to develop in the less industrialised parts of the world. All went fairly well with us on the whole until the war, diverting our productive energies into channels of mere destruction, caused us to interrupt our business of manufacturers and carriers to the world at large, and caused our customers to look elsewhere for means of supplying their needs.

The war speeded up the industrialisation of the East and the Empire, brought the United States more than ever before into world trade in manufactured goods, multiplied national frontiers in Europe and built up high tariff walls and protective arrangements against our products. The Peace confronted us with a changed economic world, in which we could no longer look confidently to a natural and inevitable expansion of the market for our exports; and it left our productive organisation both disarranged and thrown out of proportion by war-time demands, and exceedingly ill adapted for meeting the needs of the post-war market.

Three tasks then faced us. We had to recover and to hold what foreign markets were capable of retention; we had to develop a new balance in our economic system corresponding to the new forces of demand; and we had deliberately to build up our own home market as the chief means of absorbing the additional products which modern science and invention enabled us to produce.

But neither post-war Governments nor employers showed any capacity for grappling with these urgent

problems. In the name of private enterprise and *laissez faire*, State control was removed, and industry left to face its own tasks. But instead of setting about the work of reorganisation, employers in many industries—cotton is a notable example—plunged into an orgy of financial speculation, from which they emerged crippled and inert. And Governments and employers alike, instead of seeking to build up the purchasing power of the home market, cut wages and acquiesced in a vast mass of unemployment, which carried with it inevitably a depression of working-class incomes and a failure of economic demand.

The immediate provision of work, on the lines suggested in this paper, will do something to counteract this last mistake. And it will also do something, but not nearly enough, to help forward the reorganisation of our economic system and the revival of industry, that can come only when reorganisation has been carried into effect. Mr. Thomas, with his grants and guarantees in aid of economic development, is doing something more; and this part of his policy is essentially sound as far as it goes. But does it go far enough?

Most of our great industries need drastic reorganisation, re-equipment with the aid of fresh capital, co-ordination of the processes of production, improved methods of marketing, a squeezing out of watered capital and a forced liquidation of the prior financial claims of banks and bondholders, an elimination of "guinea-pig" directors and a drastic purge of inefficiency of all sorts. These are, doubtless, matters not

for Mr. Thomas alone, but for the Government as a whole. They concern Mr. Graham's department especially. But they are matters which have a vitally important bearing on the solution of the unemployment problem. For one big reason for the persistence of unemployment is the inefficiency with which many of our great industries have been managed of late.

I am making here no charge against the technical competence of the ordinary works manager. He is often a skilled man, struggling with impossible conditions. The failure lies rather in the direction of high policy, and above all in the absence of any co-ordinating direction at all, and in the impossibility for separate businesses which have once got into financial difficulty of taking the steps, or raising the capital, necessary for reorganisation in the light of modern needs.

In this work, I am convinced, the State will have to lend a hand. The mining industry does not stand alone in needing measures of compulsion—in my view far more drastic measures than the Government is yet attempting to apply—before it can be brought again into a state of reasonable efficiency. Cotton, wool, iron and steel stand in no less need of drastic "rationalisation", and are clearly no less helpless to apply it without the constructive aid and intervention of the State. I believe it will be necessary, before these industries can recover lost markets or play their part in absorbing the unemployed, for the State to compel them to adopt measures of "rationalisation", to bring them under drastic public control, and to play a large part in helping to supply the capital which they must

have if they are to be made reasonably efficient and productive.

There is need, in this sphere, for far larger measures than Mr. Thomas, in his capacity as "Minister of Unemployment", can by himself undertake. But it is Mr. Thomas's business, since to him has fallen the task of thinking out the right measures for combating unemployment, to take these wider questions within the scope of his review of the situation, and to press the need for them upon his colleagues in the Government. He may have come back from Canada assured that there are great openings for the export of British coal and British steel; but this will not carry us far unless the coal and steel industries are so reorganised as to be able to supply what the Canadians want at a price which the Canadians are ready to pay. Mr. Thomas may set about equipping the railways to carry more goods, and to carry them more efficiently. But will there be more goods to carry unless our methods of production and marketing are improved? The whole problem is essentially one. Mr. Thomas's part in it is inextricably linked up with Mr. Graham's, and both their parts with the task of the Cabinet as a whole.

There are, of course, very serious difficulties in the way of this policy of reorganising industry with State aid and under State control. Labour has no clear majority in the House of Commons; and this both makes the fate of any far-reaching measures uncertain and deprives the Government of that control of parliamentary time which is nowadays indispensable

to the carrying through of any ambitious policy. I do not suggest that Labour can do all the things that I have proposed in the present House of Commons; but I do suggest that it ought to do as many of them as it can, to make plain its intention of doing them all, and, when it has been made clear that the present House will not give it the necessary scope and authority, to appeal to the country not only with a record of achievement to its credit, but also with a policy that clearly shows its determination, at any cost, to pluck up the rank weeds of unemployment by the roots.

VI

Two things I wish to make perfectly clear before I bring this paper to a close. It is in no sense either part of a general criticism of the Labour Government and its policy or a personal attack on Mr. J. H. Thomas. For much that has been done already by Mr. MacDonald's Government I have the warmest admiration; and for the Lord Privy Seal's abilities I have a very high respect. But I happen to believe that Mr. Thomas and the Cabinet, as far as it is identified with his policy, are taking a quite inadequate view of their immediate responsibilities to the unemployed, and going, at least in part, the wrong way to work in their handling of unemployment.

Now, this problem has clearly so outstanding an importance that failure to deal with it will certainly mean shipwreck to the Government even if its work

in every other department is beyond praise. No victories at The Hague or at Washington, no work for world peace or financial settlement, no progress in housing, or pensions, or education, could possibly make up, in the eyes of the Labour Movement, for failure to take all possible steps to get the unemployed back to work and wages. Foreign and imperial affairs, social legislation and finance, are all matters of vital concern to this country; and in them all the Government has already notable achievements to its credit. But, as a political and economic problem, unemployment towers above them all. It is, above and beyond all else, the social evil that has to be fought and conquered.

Mr. Thomas has himself said that unemployment is the crucial test; and he has gone on to say that he finds the problem very hard and does not believe it admits of quick or ready solution. With both these statements every reasonable person will agree. Mr. Thomas has a hard task: the question is whether he is tackling it in the right way. I hold that he is not, and that there is no disloyalty to the Labour Government in saying so. Indeed, the harder the problem, the more necessary it is that constructive criticism should be allowed to play freely upon it. And there is the less ground for any charge of disloyalty in that I am not criticising anything that Mr. Thomas has done, but only his failure to do certain other things that are at least as necessary to the solution of the problem. If Mr. Thomas will add these things to what he is doing already, none will be better pleased than

I to take off my hat to him. But I am so convinced that, if they are not done, the Government will suffer a disaster beyond repair that I am sure it is right to speak out now, before it is too late to make a fresh start on more satisfactory lines.

The question of money is, I am convinced, largely at the back of the inadequacy of Mr. Thomas's present plans. I can picture critics of my articles—perhaps Mr. Thomas himself—as saying, "Of course, this is all very nice, and there is nothing we should like better, if it could be done, than to set all the unemployed at once to useful work. But you will admit this will involve a large immediate outlay; and where, if you please, is the money to come from? The country is poor because of unemployment; and therefore it cannot afford to spend much in setting people to work." Indeed, in some people's eyes, the chief recommendation of Mr. Thomas's plans is their cheapness; and it seems almost a minor matter that, being immediately cheap, they are also ineffective.

What is cheapness? Is it cheaper to spend a shilling on something that is worth sixpence, or ten shillings on something that is worth a pound? It has been pointed out again and again that the many millions already spent on unemployment benefit and poor relief to those out of work, necessary as they have been in default of employment, have been thrown away as far as the securing of any valuable return is considered. They have not even sufficed to maintain the unemployed in full health and bodily efficiency. In a very real sense, they have been absolutely lost.

If, when unemployment first became severe, the Government then in office had promptly spent on preventing it half as many millions as have since been spent in mere relief, the odds are that by this time we should have had no unemployment problem.[1]

If, now, the Government does not succeed in setting the unemployed to work, it will have to spend more on the relief of their needs. If there is to be no work for them, I sympathise fully with Mr. Maxton's demand for a more adequate "dole". But I would far rather see a good deal more money spent, not unproductively, but in a way that will bring back a productive return. The entire policy of "doles" instead of work is radically wrong.

Mr. Thomas, however, blows very cold on any proposals for spending more money. It is easy, he has told us, to spend money. Any fool can do that. In one sense what he says is true enough. It is true that any fool can spend money—if he has money to spend. But is not a large part of our present unemployment due simply and solely to the fact that most people are very short of money to spend? Production is low because demand is low; and demand is low because the mass of the people are too poor. And people are poor because production is low; the unemployed get no wages, the underemployed scanty wages, and even the fully employed wages that in many trades have been pressed down to a terribly low level. Low wages mean low production; and low production means low wages. In the very foreground of the problem, this

[1] This was written before the present world depression.

vicious circle of low production and low consumption menacingly confronts us.

Mr. Thomas, when he says that any fool can spend money, is doubtless thinking not of the ordinary consumer who cannot spend money unless someone pays him for his work, but of the State and its Ministers, who have, subject to Mr. Snowden's vigilance, the public purse at their command. Any Cabinet Minister, he means—any Lord Privy Seal can spend money; but only money that is wisely and productively spent is to be regarded as spent well. "I could", Mr. Thomas is saying in effect, "set all the unemployed to work shovelling sand into the sea; but that would not be money well expended. It would speedily drain dry the public resources, and it would give the public nothing in return." For my part, I am not so sure that even this would not be better than doing nothing; for to set all the unemployed to work at reasonable wages would have so great an effect on demand as might set the wheels of industry naturally revolving again at far greater speed, and thus set ordinary productive activities again in regular motion. But such a policy would be clearly wrong; for it would be obviously less beneficial than a policy that would set the unemployed to do, not something useless and foolish, but work useful and productive of lasting benefit.

"But this", Mr. Thomas may say, "is precisely what I am trying to do. I am trying to spend money wisely and in moderation, and to confine my spending to really productive uses. The Duckham Committee, the Unemployment Grants Committee and the other

bodies through which I am working exist precisely for this purpose. Are they not doing useful work?"

Yes, Mr. Thomas, we know all about these bodies; and most of the things they are doing are thoroughly desirable things to do. But we have seen that, when they have all been added up, they amount to very little in the matter of real hope for the unemployed who have been, for some years now, genuinely and vainly seeking work. You yourself cannot suggest that they amount to much. You are conscious of the difficulties of your position. You plead for our realisation that your way is hard. You ask us, "What more can I do? Any fool can spend money: what other means can I find of spending it productively and well?" It is in the belief that the means are lying under your nose, if you will only look for them, that this paper has been written.

Mr. Thomas, apparently, does not take that view. He is still convinced that the one hope of dealing with unemployment lies in the revival of foreign trade. And on this point other Ministers appear to agree with him. Foreign trade is, I agree, vastly important. But it is not the solution of the unemployment problem. Anyone who hopes to solve the problems of the Lancashire cotton trade by regaining the lost coarse cotton markets of the Far East, or the problem of coal by bringing exports and bunkers up to pre-war level at a price remunerative under present conditions of production, is labouring under a delusion.

Foreign demand for our goods may expand; I hope and believe it will. Much may be done to hold and

to develop foreign markets by more effieient organisation of produetion and by better methods of marketing. Let it be done, lest the markets we still hold to-day follow those whieh we have already lost. The hard faet remains that we eannot look to the expansion of our overseas trade to absorb the unemployed. The demand is not expansible enough. It will take us all our energies to get and keep a volume of exports equal to that of pre-war days, quite apart from so inereasing it as to absorb both our larger working population and the greater produetivity due to the rationalisation of industry.

For means of employing the unemployed we must look nearer home. The great reservoir of unused demand is in the needs of our own people. It is the home market, unlimited in its potential demand rather than the foreign market, limited by the growing industrialisation of other eountries, that must be expanded if we are to eure the disease of unemployment. Until Mr. Thomas realises that fundamental faet, and sets to work to rebuild the purehasing power of the British workers, employed and unemployed, as a means to the revival of home demand, I fear there is no hope of his taekling his admittedly diffieult task in the right way.

IV

CHEAPER MONEY, RATIONALISATION AND EMPLOYMENT

Reprinted from *The New Statesman*,
December 1929–February 1930

IV

CHEAPER MONEY, RATIONALISATION AND EMPLOYMENT

I

Most people agree that, in the long run, the American stock market collapse is likely to make for easier monetary conditions in this country. There is bound to be dislocation for a time; but the effect of recent events in America should be, before long, a better distribution of the world's financial resources. To what extent will the change be likely to react favourably on British industry and on the volume of employment which it is able to provide? Some writers on economic subjects are inclined to make optimistic forecasts of industrial recovery resulting from cheaper and easier credit, and to suggest that Mr. Thomas's task of dealing with unemployment, difficult enough now, is likely to become a good deal easier within the next year. Is there any real warrant for this view? Or is it more probable that, even if we get easier money, industry will be slow in reviving, and, even if industry revives, unemployment will be slow in falling to any considerable extent?

Both these fears, I am convinced, possess a good deal of justification. We cannot even feel assured, despite the recent optimism of the Bank of England, that cheaper money has come to stay; and we can feel even less sure that cheaper money by itself will

bring about any great revival of industry. Nor can it be prophesied with any confidence at all that industrial revival, in any form in which it shows signs of coming in the near future, will by itself do much to solve the unemployment problem. It may indeed create a new unemployment problem hardly less intractable than that which is now giving Mr. Thomas so much trouble.

It is true enough that our basic industries need drastic reorganisation, that this cannot be carried through without a substantial accession of new capital, and that the industries which need the capital most are, in present circumstances, in the worst position for raising it. But it does not follow that easier credit conditions will, by themselves, do much to help them; for, even if money were far more abundant than it is, the investor would still be shy of entrusting his savings to enterprises which are in many cases burdened with a dead weight of debts to banks and other creditors. Money, moreover, would have to be a great deal cheaper to make enough difference to costs in most industries to bring about any large recovery of markets; and there is not much likelihood that money will be a great deal cheaper. The chief ways in which easier financial conditions would help industry would be, first, in enabling the banks to go further in providing resources for approved schemes of reorganisation and development; and secondly, in enabling the Government, if it so desired, to borrow more cheaply with the same end in view. Money, however, will not by itself make the difference between prosperity and

adversity; for that is mainly a matter of the level of costs and efficiency in production.

It is, accordingly, rather to the effects of cheaper money in making easier the rationalisation of the depressed industries than to its direct effects in stimulating production that most economists seem now to be looking. But it has to be remembered that it may, for a time at least, have the opposite result. It is common knowledge that, where any measure of rationalisation has been brought about, it has usually been forced on business men only when they have been no longer able to carry on at all, and their creditors, the banks, have insisted on it as a condition of continued help. If easier money conditions meant that credit were given more readily to any of the banks' customers who asked for it, the most likely result would be that firms which are now being driven to accept measures of rationalisation would stiffen their backs and refuse to have any of it. In that case, more production might be secured immediately; but if more goods were made at the existing costs, they could not be remuneratively sold, and we should only have the present position of the coal trade repeated in other industries.

It is therefore of fundamental importance that, if credit facilities are to be increased, there shall be discrimination in allotting them, and that the new money shall be made to flow into industries which set out to cheapen costs of production and to bring their equipment and organisation up to date. The present suppliers of credit are chiefly the joint-stock banks. Will they be prepared to use their discrimination, and

to use it in the right way? Certainly, unless they are prepared, the Government itself will not be able to avoid the responsibility of assuming, directly or indirectly, some further measure of control than it has exercised hitherto. Otherwise cheap money, so far from laying the foundations of secure economic revival, may positively help to plunge industry into worse chaos than ever.

Even, however, if this very real difficulty is successfully overcome, it by no means follows that the effect of industrial reorganisation will be seen, for some time to come, in an increased volume of employment. Indeed, everyone knows that in most cases the effect of rationalisation will be to reduce the numbers employed, in the early stages of the process at least. This has been the effect of rationalisation in Germany, where a considerable number of displaced workers were reabsorbed, after an awkward interval, partly in other industries, but also to a substantial extent on the land. Our problem is likely to be the more difficult because we possess, in the present state of British agriculture, no corresponding outlet. While, therefore, any revival of industry would undoubtedly bring with it an expansion of employment in trades other than those directly affected by schemes of rationalisation, it cannot be taken for granted that it would cause any aggregate expansion over the entire industrial field; and it would certainly be quite unsafe to rely on it to solve the unemployment problem for us without other aid.

I stress this point the more because, if I under-

stand Mr. Thomas aright, he is tending more and more to look at the revival of industry as holding out the only hope for the unemployed, and to discount in advance any suggestion that his task has also another, and no less urgent, side. More and more the old view that any attempt deliberately to provide work is uneconomic and positively deleterious seems to be creeping back; and the old explanations that unemployment is not really so serious as it seems are again being produced, as they were in the days of Sir Arthur Steel-Maitland and Mr. Baldwin. Indeed, Mr. Thomas's policy appears to differ from theirs chiefly in being at present more energetic along the same lines; and whether this greater energy will survive a couple of winters' experience remains still to be seen.

I, on the other hand, take as strongly as ever the view that the unemployment problem has two distinct aspects. It is necessary, on the one hand, to take every possible step to promote more efficient production and marketing; for, unless we do this, we can have no assurance even of keeping the trade we have, let alone of getting the much more that we need. But, apart from this, it is necessary also to make special provision for setting the unemployed to useful work, not only now, while industry is depressed in many of its parts, but also subsequently, when the fresh unemployment that is bound to come from rationalisation will present, outwardly, a very similar problem.

The steps which Mr. Thomas is taking with this end in view seem to me—and, I believe, to most

observers of his policy—hopelessly inadequate. He himself is doubtless disappointed with the comparatively meagre results that have come of his efforts to speed up the provision made by local authorities by relaxing the conditions of grant aid; and perhaps he is even disposed to conclude that, as so little success has attended his strivings so far, there is really nothing to be done. For my part, I am not at all surprised at the meagreness of the response. Unemployment is highly localised. The areas which have much of it can afford to do little; and those which have little of it are not inclined to put themselves about. Indeed, the entire attempt to tackle the problem of providing work as a problem of grant aid to local bodies is, we are sure, doomed to inadequacy from the start. Nothing short of a national scheme, nationally financed and administered, is likely to make any real impression on the dimensions of the unemployed army.

These conclusions may seem to many people pessimistic. But they are not really so. The prospect of cheaper money is also, if we use our opportunity aright, the prospect of industrial recovery; and, even if this recovery does not in itself solve the unemployment problem, it will, at the very least, make the burden of maintaining the unemployed, as well as of the whole apparatus of social services, very much easier for the country to bear. Unemployment connotes a great waste of potential productive capacity; but it need not connote actual poverty. It has been seen already in America that it can coexist with a high degree of general material prosperity. Even so,

it remains a very serious problem; for the ethical are hardly less serious than the economic consequences of lack of work. Deterioration of men, as well as waste of productive resources, is a crying national evil. Industrial prosperity, however, even if we cannot rely on it to cure unemployment, would at least enable us to pay for it, not by more relief, but by setting the surplus workers to useful activity.

II

The late Mr. Walter Leaf, of the Westminster Bank, used to assert strongly—he did so with emphasis in his book on *Banking*—that the current view that the banks were the supreme arbiters of industry was based on an entire misunderstanding. As chairman of one of the Big Five, he might have been expected to know; but his statements were received with very widespread scepticism. Very few businesses, it was pointed out, could manage nowadays without making large and continuous calls on their bankers' help; and it stood to reason that this help was not given unconditionally, and that the banks must have, accordingly, an important say in the spending of the resources which they provided. Mr. Walter Leaf, however, stuck to his point. He did not say that the banks had no influence over industrial policy; but he did insist that current opinion greatly exaggerated the extent of their influence.

In a sense, he was right. On the whole, the effect of banking amalgamations undoubtedly was to make

the banks lend less on personal and more on collateral security, and therefore to make them less concerned with the purpose for which credit was needed than with the security offered for its repayment. This was especially true of small and middle-sized transactions; but it extended in some degree to big transactions as well. The big banks were inclined to say that they lent to those who could afford to borrow, and that it was rather the borrower's business than theirs to see that the money was properly expended.

It is more than possible that this attitude contributed in some degree to the situation in which the banks found themselves on the coming of the great depression of 1921 and the following years. They had lent freely to rich clients; and now they found that their clients could not pay them back, and that any attempt to force liquidation of their credits would be likely to bring widespread bankruptcies in its train. Instead of calling in their outstanding credits, they found themselves in many cases impelled to go on lending more money in order to keep struggling firms in being. They could have forced hundreds of well-known firms into bankruptcy by insisting on repayment of money due, or even by refusing further advances. They did not do this. Instead, they went on doling out money in order to help their clients to keep their heads above water, at the same time converting their earlier lendings into prior charges in the endeavour to secure themselves against ultimate loss.

In following this policy, the banks could plausibly contend that, so far from controlling industry, they

were being governed by it, and merely following helplessly the course marked out for them by the changes in business conditions. It would of course be an exaggeration to represent the banks as doing merely this; but undoubtedly this, to a considerable extent, is precisely what they did. The question is whether it was the right thing to do.

For the statement that the banks do not control, and have not controlled, industry carries with it no demonstration that they are not in a position to control it, if they so desire. To a great extent they clearly are. The mere fact that they could, at any time for some years past, have made a large number of old-established and reputable firms in many of our leading industries bankrupt, if they had desired to do so, sufficiently demonstrates the magnitude of their power. That they have refrained argues lack not of power but of will. The banker can give or refuse credits for new enterprise; he can call in, or refrain from calling in, sums due to him. The essentials of power are in his hands, if he sees fit to use it; but it is of course true that he can use it with effect only if he has a clear idea of what he is trying to do.

Even his power, moreover, is to some extent conditional. It is the power not of any one banker, but rather of the Big Five acting as a group. On a number of occasions in recent years they have not so acted; and a business refused help by one bank has secured it from another. To a still greater extent, each bank has been held back from refusing advances or pressing for repayment of outstanding loans by the refusal of

one or more of the others to join in a common policy.

These facts are well enough known to business men, though comparatively little is written about them, at any rate in a form accessible to the general public. The important point is that the bankers have not controlled industry, because they have had no policy for controlling it, and no real understanding of its problems. They have been apt to claim as a virtue their standing aloof from their clients' concerns; but this aloofness has often meant in effect a real lack of understanding.

The occasion of these remarks is the recent pronouncement of Mr. J. H. Thomas about the attitude of that nebulous thing, the City, towards economic reorganisation. The City, Mr. Thomas tells us, is now prepared to stand behind, and to provide credits for, approved schemes of rationalisation and business reconstruction. Mr. Thomas, of course, was not thinking or speaking only of the Big Five. He had in mind also the Bank of England, which has already taken the leading part in the creation of the Lancashire Cotton Corporation, and also the issuing houses and private banks which form a weighty element in City opinion. He meant not only that the Big Five, or the Bank of England in their default, would provide credits for approved schemes, but also that the rest of the City, commonly more concerned in overseas than in home issues of new capital, would for a time remove its eyes from the ends of the earth and deign to look nearer home. That Mr. Thomas spoke for the Bank

of England I have no doubt; for this has been for some time the Bank of England's policy. How far he spoke with authority for the rest of the City remains still doubtful; for the attitude he announced would involve a big change of policy on the part of the issuing houses, and still more of the Big Five. Presumably he had some warrant for what he said. The question is how much warrant; and on that matter, pending further information, we are still in the dark.

One immediate point, however, is this. If the bankers now propose to give their support to approved schemes of rationalisation and the like, this implies the creation of some working mechanism for the giving or withholding of approval. The banks will no longer be able to say that it is not their function to judge of the merits of industrial projects. They, or someone on their behalf, will have to pronounce on such projects considered judgment that will either make or mar. The German banks, even if the extent of their actual investments in industry is much less than is popularly supposed, have of course long done this, and have been accordingly in a high degree actually controllers of German industry. They have been this, be it noted, not because their power is greater, but because they have used it more. Similarly, the question now is not of endowing the British banks with fresh powers, but of providing for their fuller and more knowledgeable use. Our banks, if they are to form considered judgments on projects of industrial reconstruction, will need to have at their command experts with a real understanding of industrial conditions, and to keep constant watch

over the enterprises which they foster, probably by the method of direct representation on the boards of the companies concerned.

There is a further and most important point, which Mr. Thomas, in his Manchester pronouncement, kept discreetly in the background. If schemes of industrial reorganisation are to be made effective, it will be indispensable not only to give credits for their execution, but also to refuse credits to firms which refuse to take part. The history of the Cotton Trade Corporation amply proves the necessity of this; for it is as true as makes no matter that no firm has joined the Corporation save under the pressure of absolute necessity, and that this necessity can be imposed most easily by the banks, and can hardly be imposed in face of their opposition. In Lancashire they have been slow and reluctant to apply pressure; and in consequence the Corporation has been slow in getting under way, and has had the difficulties of its task immensely increased. Does Mr. Thomas mean that the Big Five have now changed their policy, and that, in concert with the Bank of England, they will take steps to force reluctant businesses, by the refusal of credits or by pressing for repayment of sums already due, to take part in schemes of rationalisation even against their will?

On the whole, I hope that Mr. Thomas does mean this, and that he has secured the adherence of the Big Five to a drastic policy on these lines. But if this is so—and I suspend judgment on the point of fact for the present—it evidently involves so great an

increase in the actual control exercised by the banks over industry—as distinct from the unused power to control—that their entire position in the social system will call for fundamental reconsideration. Are the banks, as they are now organised, fit to exercise this sort of power? Are they directed and staffed by men of the right calibre and qualifications? And can they themselves, if they are actually to wield this vital authority over the means of living of the whole community, be left by it uncontrolled as they have been hitherto? For rationalisation can take, from the standpoint of the community, wrong as well as right forms; and, if the power to direct and enforce rationalisation is to be centralised in the hands of the banks, the State cannot help interesting itself in the ways in which the bankers execute their trust.

III

Presumably nothing will be done, by the State at any rate, towards the reorganisation of our banking system until the Macmillan Committee has made its report. Before that influential body our bankers of all sorts are now appearing to answer for their stewardship of our financial affairs; and in due course Lord Macmillan and his colleagues will inform us of the results of their examination. Until they do, we must wait with what patience we can, or rely on the will of the bankers themselves to anticipate the judgment that is to be passed upon them. What this judgment

will be we have of course no idea; and we even find it difficult to imagine that all Lord Macmillan's colleagues will be able to agree among themselves. But we must await the outcome of their work before we can expect any important reforms to be carried into effect.

It is nevertheless worth while to begin public discussion of the question without further delay. For more and more insistently the state of our industries is forcing the financial issue to the front. We are most of us, in these days, believers in some form of industrial rationalisation; and we all recognise that in connection with any plan of rationalisation the position of the banks is of primary importance. They can help it on, or they can obstruct it. They can even, if they will, play a leading part in carrying it into effect. They can make one project, and mar another, by granting or refusing the necessary financial assistance. The bankers may have, in the working of our industrial system, only a very limited creative rôle; but they have certainly an almost unlimited power of veto, if they choose to employ it. Their attitude is therefore, in practice, apt to be decisive. It has been, during the past few years, decisive in many instances. They have vast authority in their hands; and the question is whether they are using this authority in the general interest.

Raise this point with a banker, and nine times out of ten he will begin by denying that he possesses any such authority. It is not his business, he may say, to possess any intimate acquaintance with the tech-

nical problems of industry; and accordingly it is not for him to say whether this or that particular plan of rationalising an industry, or amalgamating a group of firms, is good or bad. That is a matter for the recognised leaders in the various branches of industry; and the banker can only rely upon their opinion. It is not for him to discriminate among his clients, save in accordance with their solvency and recognised standing; and he will have done his part if he has met their claims on this basis. The responsibility of making industry more efficient is theirs, and not his; and he is the first to admit that he possesses no special competence for the control of industrial policy. He has no desire to control it; he leaves that to others, and sticks to his own job of finding safe and as far as possible liquid uses for the resources which he is able to lend.

This is, indeed, the traditional conception of British banking policy; and it may be admitted that, until after 1918, it had done no clearly demonstrable harm. Especially since the fusion of the banks into a few great national joint-stock concerns, it has undoubtedly made for easier granting of credit to the large business than to the small, and to a preference for gilt-edged or other collateral over personal security. But it is by no means certain that the former preference is economically bad; and it would be difficult to show that, up to the war, British banking was failing in any serious way to meet ordinary industrial needs. The bankers' preference for liquidity caused them to abstain not only from investing in their clients' busi-

nesses, but also from providing any large portion of the working capital of productive industry in the form of long-term credits. But the capital market was readily available to businesses of standing, when they needed fresh resources for legitimate expansion; and prosperous businesses were to a predominant extent helping to finance their own development by the allocation of a part of their profits to reserve. British industry was suffering, normally, from a shortage neither of capital nor of credit; and, while there were some who criticised our banking policy and held up the German and American banks as an example to our bankers, there was in effect no serious or widespread dissatisfaction with the working of our financial machine.

Since 1918, however, and especially during the past few years, the position has been widely different. Capital is far less plentiful than it was; and there are not many productive businesses to-day, at any rate in the basic industries, that would venture to appeal for new capital on the open market. Profits have been low in these industries, or too often losses have taken their place; and accordingly there has been little scope for additions to working capital out of reserves. Moreover, this condition hits hardest just those firms and industries that stand in the greatest need of drastic reconstruction; and the process of reconstruction, however profitable it may be in the long run, usually costs a good deal in the first instance, and locks up the money needed either lastingly or for a considerable time. Accordingly, there has been a growing demand for a change in banking policy. The banks, it has

been urged, must step into the place that has been left vacant by the collapse of the traditional methods of financing industrial development, and must help on a far larger scale than their traditions allow in providing both capital for reorganisation and long-term credits for business expansion. The German banks, it is urged, do this; and German industry could not possibly dispense with their services in these respects. Why cannot the British bankers adopt a like attitude?

It is pertinent to observe at this point that the position of the German banks in this matter is often misunderstood. They do not in fact acquire *and hold* large blocks of shares in the undertakings of their clients. They do buy shares, especially those issued for the expansion of existing businesses, on a considerable scale; but usually they buy with the intention of selling their holdings as soon as market conditions allow. The German banks, no more than the British, regard it as their function to supply permanently the capital that must be locked up in productive industry. They supply long-term credits on the whole more readily than the British banks, and they act far more as agents for the gradual dispersal of new shares into the hands of the public. But, apart from this latter service, their essential function is to supply credit, and not permanent capital.

The distinction, of course, is that capital must in the final resort be drawn from what are called "savings"; whereas credit need not. Credit, even where it is not actually "created" by the banker, depends rather upon the floating balances temporarily in his hands. Now,

British industry stands, at the present moment, in need of capital even more than of credit. Far from being faced with orders which it cannot fulfil for lack of credits, it is in danger of being without orders for lack of the new capital to apply to necessary works of reconstruction. Is it, or is it not, the function of the banks to supply this lack? According to traditional banking practice, it certainly is not; but new situations demand new methods, and if they do not fill the gap, it is not easy to see whence the necessary resources are to come. One alternative is that the Bank of England should assume generally, as it has already assumed in the case of the Cotton Trade Corporation, the rôle of industrial financier, leaving the joint-stock banks to confine themselves to the provision of liquid resources. This, indeed, is what is almost bound to happen, unless the joint-stock banks do change their policy; for the needed resources must be supplied, and there is no other available source unless the State itself directly enters the field. But the serious entry of the Bank of England into the field of industrial capitalisation will almost certainly force the hands of the joint-stock banks, which will by no means want to encourage an invasion of their sphere of influence by the Bank of England.

It seems, then, that, with or against their will, the joint-stock banks are likely to become at least temporary suppliers of capital for the reorganisation of the basic industries. This, however, involves not only a new departure on their part, requiring heavier capitalisation than has so far been customary in

relation to the scale of their operations, but also a reversal of the policy they have been pursuing during the past few years. For undoubtedly business men are reluctant to agree to a rationalisation which threatens their individualism save under the spur of unavoidable necessity. And, no less certainly, the joint-stock banks have, by continuing to advance money to their clients without much inquiry into the wider aspects of economic policy, been enabling firms —in the cotton and coal industries, for example—to stand out against measures of rationalisation to which both the Government and the Bank of England have been favourably disposed. If rationalisation is the right policy for industry, its furtherance certainly involves not only the granting of credits to enterprises which are to be rationalised, but also the refusal of credits to those which stand out of any approved scheme of reorganisation.

The adoption of this policy would, of course, mean that the banks would have in many cases to cut losses already incurred. They would have to forgo sums legally due to them in order to promote the reorganisation of industry on more efficient lines. They have been so far most reluctant to do this, and have justified their reluctance on the ground that they have no desire to assume the controlling function in industry. But this attitude can hardly be much longer maintained. This country has no longer resources of either capital or credit which it can afford to waste, or to suffer to be expended in any save the most urgent and economically sound forms of enterprise. The

banker must, in the public interest, ration credit more than ever before with a view to its most productive use in bringing about the restoration of our industries to health and efficiency of service. But he cannot do this without becoming to a great extent the arbiter of industry. What changes this new position of the joint-stock banks will involve in their control and administration, and in their relations both to the Bank of England and to the State, is a matter that will undoubtedly come up for public discussion when the Macmillan Committee makes its report. Even before that our bankers have to face the practical issue. Are they for rationalisation or against it? If they profess to be its supporters, they must be ready to assume a new function in the rationing of capital for industrial use. And, if they are to do this, they must learn to do it well, and must reform their directorates and staffs in the light of this new need. The public is not satisfied that the leaders of banking opinion are as yet at all alive either to the new needs or to their practical implications; and if the bankers desire to preserve their independence, they will be wise, by timely measures of internal reorganisation, to anticipate the public verdict upon their stewardship. Industry, most of us agree, needs rationalisation. Does joint-stock banking need it less?

IV

Unemployment is getting worse. Despite a marked improvement in the condition of the coal trade, there

has been a large increase in the total numbers out of work; and there is every sign that, apart from seasonal variations, the present downward trend is likely to continue. Mr. Thomas, in his recent statements, has admitted the gravity of the situation, while anxious naturally to put the best face upon it; and it is clear that he has quite given up the hope of doing anything immediately by way of finding work for the main body of the unemployed. In Mr. Thomas's view, as in that of the permanent Civil Servants with whom he is chiefly working, there is no short-run remedy or even mitigation. The sole cure for unemployment lies in the revival of industry, and that in turn depends on the recovery of markets overseas, and that in its turn on rationalisation. Until we have rationalised our industries, and then recovered our markets, the unemployed must put up with their plight; for, as Mr. Thomas sees it, the provision of work by the State can affect only a small proportion of the whole.

This view does not pass unchallenged either in the ranks of the Labour Party or within the Government itself. It has been for some time common knowledge that Mr. Thomas was not wholly at one with the other Ministers appointed to collaborate with him in dealing with unemployment. Mr. Lansbury has been almost ostentatiously leaving the matter alone, and attending to other things within his department's scope. Sir Oswald Mosley has been noticeably restive, and his speeches both in the House of Commons and outside have been very different in tone from those

of Mr. Thomas. It is probably absurd to speak, as some newspapers have spoken, of a split in the Government as either actual or impending. But the existence of strong differences of opinion no one is likely to deny.

There are, in effect, three schools of thought within the Labour Party upon the whole question. Mr. Thomas and those who agree with him hold that relief works on any large scale would be too expensive and uneconomic, and that accordingly the State must in the main confine itself to the payment of "doles" until long-run measures of industrial organisation have had time to take effect. This is, broadly speaking, the present policy, and it appears to have the backing of the Ministry of Labour, and probably of the Board of Trade as well.

Secondly, there is the school of which Mr. Maxton is the most extreme and vocal exponent. Mr. Maxton and his friends differ from Mr. Thomas in denying that rationalisation of industry is likely to cure unemployment, even in the long run. Disbelieving in Mr. Thomas's long-run remedy, they insist that the business of the Labour Party is to extend and intensify as much as possible the policy of maintenance. They want to increase unemployment benefits, to raise the school-leaving age with handsome maintenance allowances, to introduce family allowances all round, to pension off the older workers in industry at a living rate in order to make room for the younger unemployed—in short, both to reduce unemployment by removing large classes from the category of "employables", and to distribute more purchasing power to

the workers by means of drastic taxation of the rich, in the hope that this may so increase demand as to bring about the revival of industry. There is probably no whole-hogging advocate of this view in the Cabinet itself; but certain Ministers, notably Mr. Lansbury, are known to be in sympathy with some parts of it—with the proposal to pension off the older workers, for example.

Thirdly, there remains the school of thought which insists that an integral part of any satisfactory policy must be a big emergency scheme for the provision of work. Those who hold this view do not necessarily or for the most part disagree with or disapprove of Mr. Thomas's long-run measures for the reorganisation of industry. They may, indeed, regard them as no less indispensable than immediate schemes of work. But they insist that, for some time to come, rationalisation is more likely to cause unemployment than to prevent it; and they hold it to be both intolerable and uneconomic to leave the unemployed in idleness until this period is over. Most of them are doubtful, at the least, of the economic soundness of the extended "doles" advocated by Mr. Maxton and his friends. They want to put more purchasing power into the workers' pockets; but they want to set the worker producing in return, and they believe that this can be done economically on a far larger scale than Mr. Thomas is prepared to admit. Sir Oswald Mosley is said to be largely identified with this view, while he has also some points of affinity with the views of Mr. Maxton and the I.L.P.

The memorandum which has been before the Cabinet in the names of Mr. Lansbury, Sir Oswald Mosley, and Mr. Thomas Johnston seems to be a mingling of elements from the two views just described. It is evidently critical of Mr. Thomas; but it criticises him mainly not for what he is doing, but for what he has left undone. It does not, like Mr. Maxton and Mr. Wheatley, challenge the policy of furthering rationalisation in the hope of promoting the revival of industry; but it does urge, as I have urged repeatedly in these papers, that such a policy can only deal with half of the problem. It needs to be supplemented by other measures, with the double object of reducing the numbers of men and women who are competing for employment, and of providing more work for those who remain. With the second group, it wants pensions for aged workers and maintenance allowances for those who stay at school and so remain out of the labour market. With the third group, it wants far more active measures for the provision of useful work by or with the help of the State. It may thus hope to enlist support from both bodies of critics who are at present aiming their darts at Mr. Thomas's and the Cabinet's lack of a comprehensive policy.

I have not seen the memorandum, and I do not know what relative emphasis it puts on the two possible lines of action. For my part, I believe that for the present the main emphasis ought to be put on the provision of work, both because that is far better for the unemployed, and because, if the right kinds of

work are set on foot, it can be made a means not only to immediate help for the unemployed, but also to the restoration of national efficiency. There are serious dangers and difficulties in the way of any great extension of doles and allowances—of any big scheme for pensioning off the older workers, for example. Such a plan involves either more consumption without more production, or a wholesale diversion of purchasing power which is likely to be met largely at the expense of savings. I am far from believing such a diversion to be impossible, or incompatible with the maintenance of national savings, at the right time and under the right conditions; but I do not see how a minority Government can secure these conditions, at any rate in the immediate future. Consequently I hold that, if it is indispensable, as surely it is, to increase working-class purchasing power by raising the incomes of those who are now unemployed, it is also indispensable to get more production in return. In other words, we can afford to pay the unemployed more only if we set them to work to produce at least a part of their keep.

This is not to say that all increases in allowances should be ruled out. In connection with the higher school-leaving age, for example, maintenance allowances are clearly necessary, and can be generously provided without unbearable cost. But any general scheme for removing the older workers from industry would be a far more expensive business; and, if the Chancellor of the Exchequer has only a limited sum of money to spend, I would sooner see most of it

spent in putting men to work than in removing them from the labour market. There may be exceptions; for example, there are strong arguments for the pensioning of the older miners as a special case. But the annual sum that would be needed to provide any general pension to all the older workers on a sufficient scale to withdraw them wholly from the labour market could be a good deal better spent in other ways.

This view may, for all I know, be quite consistent with that of the Lansbury-Mosley memorandum. But it is clearly possible that the growing body of discontent with Mr. Thomas's policy may foster the development of Mr. Maxton's school of thought rather than the demand for an enlarged scheme for the provision of work. This would be a calamity; it would put Mr. Snowden in a very difficult position and jeopardise the Government's precarious control over the House of Commons, and it would be positively worse for the unemployed than the provision of work. What is clear is that a new policy is needed. Mr. Thomas is doing half the job he was appointed to do, and doing it, so far as one can judge, reasonably well. But that half is not enough. From a party point of view, the Government dare not face the country with a confession that it is powerless to check the growth of unemployment; and, from the national point of view no less, a continuance of the present situation is too grave in its effects on morale and on physical well-being to be tolerated. So far, Mr. Thomas has doubtless buoyed himself up with the hope that the difficulty of his task would be mitigated by a natural

improvement in trade. He told us some months ago that if we would but await February in patience, things would almost certainly be better. They are not better, but much worse; and the American collapse, while it has improved the financial situation, and thus made easier the expansion of industry, has in other respects resulted in depressing trade rather than stimulating it. We have to make up our minds to the fact that external forces will not do our job for us. We shall have to work out our own salvation; and no measures for the long-run improvement of industrial efficiency will avail to save us if in the meantime we leave the unemployed to grow in numbers and to suffer all the deteriorating consequences of prolonged inactivity and despair.

What should be done then is this. Let Mr. Thomas be left to get on with rationalisation and other long-run measures for industrial revival. But let us have also another department, under a Minister of its own, with the sole mission of working out a big scheme for employing the unemployed at useful work. If that is the outcome of the Lansbury-Mosley memorandum, both the Labour Party and the country will have good cause for congratulation.

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